93-214

No. _____

Supreme Court, U.S.
FILED
AUG 10 1993
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In the Supreme Court of the United States

October Term, 1993

FRANK L. BRYANT, KEMPER SECURITIES, INC., a Delaware Corporation (formerly known as BATEMAN EICHLER, HILL RICHARDS, INC.), CHARLES R. HEMBREE, and KINCAID, WILSON, SCHAEFFER & HEMBREE, P.S.C., a Kentucky Corporation,

PETITIONERS,

v.

CALVIN KLEIN, GEORGE E. LAYMAN, JR., GEORGE E. LAYMAN, ZENYA YOSHIDA, DBA SHADAI FARMS, KENNETH FRANZHEIM, II, BLAS R. CASARES, EARL H. SHULTZ, RICHARD L. SCHULTZ, VIRGINIA M. McGONIGLE, JOHN F. McGONIGLE, H. JAMES GRIGGS, BARRY K. SCHWARTZ, FOREST ACRES PARTNERSHIP, a Washington State General Partnership, BARRY K. SCHWARTZ PARTNERSHIP, a New York Partnership and ROBERT D. STRATMORE,

RESPONDENTS.

APPENDICES TO PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

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No. _____

In the Supreme Court of the United States

October Term, 1993

FRANK L. BRYANT, KEMPER SECURITIES, INC., a Delaware Corporation (formerly known as BATEMAN EICHLER, HILL RICHARDS, INC.), CHARLES R. HEMBREE, and KINCAID, WILSON, SCHAEFFER & HEMBREE, P.S.C., a Kentucky Corporation,

PETITIONERS,

v.

CALVIN KLEIN, GEORGE E. LAYMAN, JR., GEORGE E. LAYMAN, ZENYA YOSHIDA, DBA SHADAI FARMS, KENNETH FRANZHEIM, II, BLAS R. CASARES, EARL H. SHULTZ, RICHARD L. SCHULTZ, VIRGINIA M. McGONIGLE, JOHN F. McGONIGLE, H. JAMES GRIGGS, BARRY K. SCHWARTZ, FOREST ACRES PARTNERSHIP, a Washington State General Partnership, BARRY K. SCHWARTZ PARTNERSHIP, a New York Partnership and ROBERT D. STRATMORE,

RESPONDENTS.

APPENDICES TO PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

APPENDIX A

George E. LAYMAN, et al., Plaintiffs,

v.

Brownell COMBS, II, et al., Defendants.

Frank L. BRYANT, Counter-claimant-Appellant,

v.

George E. LAYMAN and George E. Layman, Jr., d/b/a Forest Acres Partnership, a Washington general partnership; Barry K. Schwartz and Calvin Klein d/b/a Barry K. Schwartz Partnership; Earl H. Schultz; and Kenneth Franzhein, II, Counter-claim-defendants-Appellees.

George E. LAYMAN, et al., Plaintiffs,

v.

Brownell COMBS, II, et al., Defendants.

BATEMAN EICHLER, HILL RICHARDS, INC., and Robert J. McGuiness, Counter-claimants-appellants

v.

E. LAYMAN and George E. Layman, Jr., d/b/a Forest Acres Partnership, a George Washington general partnership; Barry K. Schwartz and Calvin Klein d/b/a Barry K. Schwartz Partnership; Earl H. Schultz; and Kenneth Franzhein, II, Counter-claim-defendants-Appellees.

George E. LAYMAN, et al., Plaintiffs,

v.

Brownell COMBS, II, et al., Defendants.

Charles R. HEMBREE; Kincaid, Wilson, Schaeffer and Hembree, P.S.C., Counter-claimants-Appellants,

v.

George E. LAYMAN and George E. Layman, Jr., d/b/a Forest Acres Partnership, a Washington general partnership; Barry K. Schwartz and Calvin Klein d/b/a Barry K. Schwartz Partnership; Earl H. Schultz; and Kenneth Franzhein, II, Counter-claim-defendants-Appellees.

H. James GRIGGS, Plaintiff,

v.

Brownell COMBS, II, et al., Defendants.

BATEMAN EICHLER, HILL RICHARDS, INC., and Robert J. McGuiness, Counter-claimants-Appellants,

v.

H. James GRIGGS, Counter-claim-defendant-Appellee.

H. James GRIGGS, Plaintiff,

v.

Brownell COMBS, II, et al., Defendants.

Charles R. HEMBREE; Kincaid, Wilson, Schaeffer and Hembree, P.S.C., Counter-claimants-Appellants,

v.

H. James GRIGGS, Counter-claim-defendant-Appellee.

Zenya YOSHIDA d/b/a Shadai Farm, Plaintiff,

v.

Brownell COMBS, II, et al., Defendants.

Frank L. BRYANT, Defendant-counter-claimant-Appellant,

v.

YOSHIDA d/b/a Shadai Farm, Counter-claim-defendant-Appellee.

Zenya YOSHIDA d/b/a Shadai Farm, Plaintiff,

v.

Brownell COMBS, II, et al., Defendants.
BATEMAN EICHLER, HILL RICHARDS, INC.; Robert J. McGuiness, Counter-claimants-Appellants,

v.

Zenya YOSHIDA d/b/a Shadai Farm, Counter-claim-defendant-Appellee.
Zenya YOSHIDA d/b/a Shadai Farm, Plaintiff,

v.

Brownell COMBS, II, et al., Defendants.
Charles R. HEMBREE; Kincaid, Wilson, Schaeffer and Hembree, P.S.C., Counter-claimants-Appellants,

v.

Zenya YOSHIDA d/b/a Shadai Farm, Counter-claim-defendant-Appellee.
Robert D. STRATMORE, Plaintiff,

v.

Leslie COMBS, II, et al., Defendants.
Frank L. BRYANT, Counter-claimant-Appellant,

v.

Robert D. STRATMORE, Counter-claim-defendant-Appellee.
Robert D. STRATMORE, Plaintiff,

v.

Leslie COMBS, II, et al., Defendants.
BATEMAN EICHLER, HILL RICHARDS, INC., and Robert J. McGuiness, Counter-claimants-Appellants,

v.

Robert D. STRATMORE, Counter-claim-defendant-Appellee.

Robert D. STRATMORE, Plaintiff,

v.

COMBS, II, et al., Defendants. Lesli
Charles R. HEMBREE, and Kincaid, Wilson, Schaeffer
and Hembree P.S.C., Counter-
claimant-Appellants,

v.

Robert D. STRATMORE,
Counter-claim-defendant-Appellee.
Richard D. SCHULTZ, Plaintiff,

v.

BATEMAN EICHLER, HILL RICHARDS, INC., et al.,
Defendants.
Frank L. BRYANT, Counter-claimant-Appellant,

v.

Richard L. SCHULTZ,
Counter-claim-defendant-Appellee.
BATEMAN EICHLER, HILL RICHARDS, INC.; Robert
J. McGuiness, Counter-claimant-
Appellant,

v.

Richard L. SCHULTZ,
Counter-claim-defendant-Appellee.
Richard D. SCHULTZ, Plaintiff,

v.

BATEMAN EICHLER, HILL RICHARDS, INC., et al.,
Defendants.
Charles R. HEMBREE; Kincaid, Wilson, Schaeffer &
Hembree, P.S.C., Counter-
claimants-Appellants,

v.

Richard L. SCHULTZ,
Counter-claim-defendant-Appellee.

Blas R. CASARES,
Plaintiff-counter-claim-defendant-Appellee,
v.
SPENDTHRIFT FARM, INC., Defendant,
and
Frank L. Bryant, Defendant-counter-claimant-Appellant.
Blas R. CASARES, Plaintiff,
v.
SPENDTHRIFT FARM, INC., et al., Defendants.
BATEMAN EICHLER, HILL RICHARDS, INC., a
Delaware corporation; Robert J.
McGuiness, Counter-claimants-Appellants,
v.
Blas R. CASARES, Counter-claim-defendant-Appellee.
Blas R. CASARES, Plaintiff,
v.
SPENDTHRIFT FARM, INC., et al., Defendants.
Charles R. HEMBREE; Kincaid, Wilson, Schaeffer &
Hembree, P.S.C., a Kentucky
professional corporation, Counter-claimants-Appellants,
v.
Blas R. CASARES, Counter-claim-defendant-Appellee.
John F. McGONIGLE; Virginia M. McGonigle, Plaintiffs,

v.
Leslie COMBS, II, et al., Defendants.
Frank L. BRYANT,
Defendant-counter-claimant-Appellant,
v.
John F. McGONIGLE; Virginia M. McGonigle,
Counter-claim-defendants-Appellees.
John F. McGONIGLE; Virginia M. McGonigle, Plaintiffs,
v.

Leslie COMBS, II, et al., Defendants.
BATEMAN EICHLER, HILL RICHARDS, INC.; Robert J. McGuiness, Defendants-counter-claimants-Appellants,
v.
John F. McGONIGLE; Virginia M. McGonigle, Counter-claim-defendants-Appellees.
John F. McGONIGLE; Virginia M. McGonigle, Plaintiffs,
v.
Leslie COMBS, II, et al., Defendants.
Charles R. HEMBREE; Kincaid, Wilson, Schaeffer and Hembree, P.S.C., Defendants-counter-claimants-Appellants,
v.
John F. McGONIGLE; Virginia M. McGonigle, Counter-claim-defendants-Appellees.
Robert D. STRATMORE, Plaintiff,
v.
Leslie COMBS, II, et al., Defendants.
Garth GUY, Defendant-counter-claimant-Appellant,
v.
Robert D. STRATMORE, Counter-claim-defendant-Appellee.
Leslie COMBS, II, et al., Defendants,
and
Garth Guy, Defendant-counter-claimant-Appellant,
v.
George E. LAYMAN and George E. Layman, Jr., d/b/a Forest Acres Partnership, a Washington general partnership; Barry K. Schwartz and Calvin Klein d/b/a Barry K. Schwartz Partnership, a New York general partnership; Earl

H. Schultz; and Kenneth Franzhein, II,
Counterclaim-defendants-Appellees.
Zenya YOSHIDA d/b/a Shadai Farm, Plaintiff,
v.
Brownell COMBS, II, et al., Defendants.
Garth GUY, Defendant-counter-claimant-Appellant,
v.
Zenya YOSHIDA d/b/a Shadai Farm,
Counter-claim-defendant-Appellee.
John F. McGONIGLE; Virginia M. McGonigle, Plaintiffs,
v.
Brownell COMBS, II, et al., Defendants.
Garth GUY, Defendant-counter-claimant-Appellants,
v.
John F. McGONIGLE; Virginia M. McGonigle,
Counter-claim-defendants-Appellees.
Blas R. CASARES, Plaintiff,
v.
Brownell COMBS, II, et al., Defendants.
Garth GUY, Defendant-counter-claimant-Appellant,
v.
Blas R. CASARES, Counter-claim-defendant-Appellee.
Richard D. SCHULTZ, Plaintiff,
v.
Leslie COMBS, II, et al., Defendants.
Garth GUY, Defendant-counter-claimant-Appellant,
v.
Richard L. SCHULTZ,
Counter-claim-defendant-Appellee.
HAMILTON PARTNERS, et al., Plaintiffs,
v.
Brownell COMBS, II, et al., Defendants.
Garth GUY, Defendant-counter-claimant-Appellant,

v.

HAMILTON PARTNERS, an Ohio general partnership; Frank E. Fowler; James P. Coleman; Mercer Reynolds III; William O. Dewitt, Jr.; Northwood Ventures; Peter G. Schiff; Gateway Investment Partnership; Calvin Ingram, Counter-claim-defendants-Appellees.

H. James GRIGGS, Plaintiff,

v.

Leslie COMBS, II, et al., Defendants.

Frank L. BRYANT, Defendant-counter-claimant-Appellant,

v.

H. James GRIGGS, Counter-claim-defendant-Appellee.

H. James GRIGGS, Plaintiff,

v.

Brownell COMBS, II, et al., Defendants.

Garth GUY, Defendant-counter-claimant-Appellant,

v.

H. James GRIGGS, Counter-claim-defendant-Appellee.

Nos. 89-16621, 16622, 16623, 16641, 16642, 16644, 16646, 16647, 16648, 16650, 16651, 16657, 16658, 16660, 16665, 16666, 16667, 16670, 16674, 16675, 16680, 16684, 16686, 16688, 16690, 16692, 16696, 16698, 16726.

United States Court of Appeals,

Ninth Circuit.

Argued and Submitted Sept. 13, 1991.

Decided Dec. 17, 1992.

Appeal from the United States District Court for the Northern District of California.

Before CANBY and KOZINSKI, Circuit Judges, and CARROLL,* District Judge.

CANBY, Circuit Judge:

Certain defendants in *McGonigle v. Combs*, 968 F.2d 810 (9th Cir.1992), appeal the district court's summary judgment rejecting their counterclaim for attorneys' fees.[1] The counterclaim alleged that the defendants were entitled to recover their fees because the plaintiffs' breaches of certain warranties triggered an indemnification clause to which plaintiffs had agreed. In addition, defendant Frank Bryant appeals the district court's denial of his requests for attorneys' fees under Section 11(e) of the Securities Act of 1933, 15 U.S.C. § 77k(e) (1988), Rule 11 of the *Federal Rules of Civil Procedure*, and Rule 37(c) of the *Federal Rules of Civil Procedure*. We reverse and remand the district court's denial of Bryant's request for attorneys' fees under Section 11(e), and we affirm the district court's rejection of the remaining claims.

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* The Honorable Earl H. Carroll, United States District Judge for the District of Arizona, sitting by designation.

[1] Defendant Frank Bryant also claims certain other damages arising from the plaintiffs' breach of warranties, which he asserts are covered by the indemnity clause.

THE DEFENDANTS' CONTENTION THAT THE SUBSCRIPTION AGREEMENT ENTITLES THEM TO ATTORNEYS' FEES

Factual Background

This counterclaim is one of many components of a complex securities litigation involving Spendthrift Farms, a thoroughbred horse breeder. Plaintiffs were investors in a private placement of Spendthrift stock; when the thoroughbred market declined, they sued a string of defendants, alleging a variety of fraudulent acts and omissions. The district court granted summary judgment for the defendants on most of the claims and directed a verdict on several others; the jury returned a complete defense verdict on the remaining claims. The merits of the lawsuit are considered in *McGonigle v. Combs*, and other related issues are treated in *Schultz v. Hembree,* 975 F.2d 572 (9th Cir.1992).

After the defendants prevailed on all counts, several of them--Frank Bryant; Robert McGuiness and his employer, the investment banker Bateman Eichler, Hill Richards, Incorporated; and Charles Hembree and his law firm, Kincaid Wilson, Schaeffer & Hembree, P.S.C.--pressed this counterclaim seeking reimbursement of the attorneys' fees they incurred. The basis of these defendants' counterclaim is a subscription agreement attached as an appendix to the Private Placement Memorandum ("PPM") for the private offering of shares in Spendthrift. Each of the plaintiffs signed the subscription agreement in the course of his or her purchase of shares in Spendthrift.[2] The subscription

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[2] Investor Blas Casares contends on appeal that he did not sign the agreement until after the stock was issued in his name, and, (continued...)

agreement contains, inter alia, twenty-two "representations and warranties" that occupy more than three pages of single-spaced type. These representations include, for example, that "it has been called to [the investor's] attention both in the [Private Placement] Memorandum and by those individuals with whom he has dealt in connection with his investment in the shares that his investment in the Company involves a substantial degree of financial risk," and that "[the investor] has received no representations or warranties from the Sellers or any of the Sellers [sic] officers, directors, employees or agents other than those contained in the [Private Placement] Memorandum." Each investor further warrants, among other things: that he has a net worth of at least $5,000,000 and is knowledgeable in financial matters; that he has read the PPM; that he understands that the shares are subject to restrictions on transfer; that he is not purchasing the shares with a view to resale; and that he will not sell or transfer his shares without providing the sellers with an unqualified opinion of counsel that the sale or transfer "complies with the 1933 Act and any applicable federal and state securities laws and regulations."

The subscription agreement also contains an indemnification clause, which states as follows:

5. *Indemnification*. The foregoing representations and warranties are made by the Subscriber with the intent that they may be relied upon in determining his qualification and suitability to purchase Shares, and the Subscriber hereby agrees that such representations and warranties shall

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[2](...continued)
therefore, that he is not bound by the indemnity provision. In light of our affirmance of the district court's ruling, we do not reach the question whether Casares was bound by that provision.

survive his purchase thereof. The Subscriber hereby agrees to indemnify and hold harmless the Company, the Sellers and agents of each of them from and against any losses, claims, damages, liabilities, expenses (including attorneys' reasonable fees and disbursements), judgements and amounts paid in settlement resulting from the untruth of any of the warranties and representations contained herein, or the breach by the Subscriber of any of the covenants made by him herein. Notwithstanding the foregoing, however, no representation, warranty, acknowledgement or agreement by the Subscriber made herein shall in any manner be deemed to constitute a waiver of any rights granted to him under Federal or State securities laws.

The defendants argue that, in pursuing this litigation, the plaintiffs breached their warranties in the Subscription Agreement by averring, for example, that they relied on representations made by the defendants outside of the PPM and that they were misled into believing that their investment in Spendthrift entailed little risk. The defendants contend that, in light of those breaches, the indemnification clause obligates the plaintiffs to pay the defendants' attorneys' fees.

Discussion

The material facts are not in dispute; the plaintiffs acknowledged for purposes of summary judgment that they breached certain provisions of the security agreement in bringing their lawsuit. The plaintiffs contend, however, that they are not obligated to reimburse the defendants for their attorneys' fees because the indemnification clause is limited to liability arising from breaches that cause the sellers to lose their private placement registration exemption under SEC Rule 506, 17 C.F.R. § 230.506 (1992), or comparable

exemptions under state blue sky laws. The sellers have not lost any such exemption. Thus the only question before us is a straightforward one: Does the indemnification clause obligate the plaintiffs, who are assumed to have breached their warranties, to pay the attorneys' fees of the defendants that were incurred in defending the plaintiffs' unsuccessful claims?[3]

The first page of the PPM states that

> [t]he Sellers will impose certain standards which prospective investors must meet in order to be eligible to purchase the shares. These suitability standards are designed to assure compliance with Section 4(1) of the Securities Act of 1933 and Regulation D promulgated by the Securities and Exchange Commission thereunder and with the Blue Sky Laws of the states in which this offering will be made.

This concern that the offering meet all the requirements for a registration exemption is reflected in the representations and warranties of the subscription agreement, which--as both the plaintiffs and the defendants acknowledge--contain the "suitability standards" mentioned in the sentence above. As a result, many of the representa-

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[3] Because none of the parties suggests that we apply any particular state's substantive law, we apply the law of the forum state, California. Under California law, a court interpreting a contract should "look for expressed intent, under an objective standard." 1 B.E. Witkin, *Summary of California Law Contracts* 684 (9th ed. 1987); accord *Stevenson v. Oceanic Bank*, 223 Cal.App.3d 306, 272 Cal.Rptr. 757, 763 (Cal.Ct.App.1990).

tions in the subscription agreement track, verbatim, the language of Regulation D.

More important for our purposes, the opening sentence of the indemnification clause focuses on the suitability standards: "The foregoing representations and warranties are made by the Subscriber with the intent that they may be relied upon in determining his qualification and suitability to purchase Shares, and the Subscriber hereby agrees that such representations and warranties shall survive his purchases thereof." This language indicates that the focus of the indemnification was on ensuring, first, that the suitability standards were met, so that the sellers could retain their private placement registration, and, second, that, if the registration were lost and damages resulted, the investor who caused the loss would be liable.

The defendants would have us focus on the second sentence of the indemnification clause, which states that

> [t]he Subscriber hereby agrees to indemnify and hold harmless the Company, the Sellers and agents of each of them from and against any losses, claims, damages, liabilities, expenses (including attorneys' reasonable fees and disbursements), judgements and amounts paid in settlement resulting from the untruth of any of the warranties and representations contained herein, or the breach by the Subscriber of any of the covenants made by him herein.

The defendants point to the broad language of this sentence in support of their contention that the indemnification is not limited to a loss of the registration exemption, but rather applies to all losses that result from a breach

of a representation or warranty--even losses arising from this suit brought by the indemnitors. It is true that this sentence, viewed in isolation, could be read so broadly. But this sentence does not appear in isolation. It immediately follows a sentence focusing on the suitability standards for a private placement exemption. The section of the document in which it appears focuses primarily on the suitability standards. The placement of the indemnification (i.e., immediately after the section on the suitability standards) gives no intimation of a broader purpose than to indemnify for liability arising from loss of the private placement exemption. Moreover, the first page of the PPM sets the stage by focusing on suitability standards. In light of this context, we conclude that the unambiguous[4] expressed intent of the clause is that any investor whose breach of a representation causes the sellers to lose their private placement exemption is obligated to reimburse the sellers for their losses. In our view, a reasonable investor who read the PPM and the subscription agreement would so interpret the indemnification clause.

This analysis comports with that of the leading case on the application of indemnification clauses, *Zissu v. Bear, Stearns & Co.*, 805 F.2d 75 (2d Cir.1986). *Zissu*, like our case, involved a plaintiff who brought suit under the securities laws, alleging, among other things, that he had relied on certain oral misrepresentations. *Id.* at 76. As was

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[4] The defendants contend that, at most, the clause is ambiguous because the literal language of the indemnity clause can be read to cover this case. They assert that summary judgment is therefore improper. We find no ambiguity, but in any event we conclude, for reasons set forth in the text of our opinion, that no rational trier of fact could attribute to the clause the meaning urged by the defendants.

the case here, *Zissu* had warranted in his subscription agreement that no oral representations had been made to him. *Id.* at 77. Furthermore, the indemnification clause in *Zissu* was similar to the one in this case, in that *Zissu* agreed to indemnify and hold harmless the sellers "against any and all loss, damage or liability due to or arising out of a breach of any representation or warranty" that he had made in the subscription agreement. *Id.* The clause in *Zissu* did not mention attorneys' fees, and the court underscored that omission, but the court's reasoning went beyond the mere presence or absence of the words "attorneys' fees":

> The "any and all damages" clause of the Subscription Agreement in this case did not meet the requisite level of specificity necessary to hold *Zissu* liable to reimburse Encore and Bear Stearns for defense costs in their successful defense against *Zissu*'s securities claims. The clause *Zissu* signed did not put him on notice that he would be responsible for defendants' legal fees incurred in the security fraud suit. In fact, no mention of attorney's fees was made in the indemnification clause. Instead, the warranties in question were necessary to exempt the limited partnership from the requirements of the 1933 Act and are so understood by investors. That being the case, the parties had little reason to expect that such warranties might also be the basis for the counterclaim made in the present case. Thus, although New York courts have held that contractual indemnity provisions for attorneys' fees will be enforced, and broad indemnification provi-

> sions like the one here should be read to extend to such fees, a higher level of specificity is required when attorneys' fees are being assessed against a plaintiff suing for securities fraud.

Id. at 79-80 (citations omitted).

Zissu thus focused on both the absence of any reference to attorneys' fees and the failure of the indemnification clause to put Zissu on notice that the clause was not limited to reimbursement for the loss of the registration exemption. The defendants suggest that the subscription agreement's reference to attorneys' fees renders Zissu inapplicable, but we disagree. Our reading of Zissu is that a reference to attorneys' fees is necessary but not sufficient; the crucial element of an indemnification is that it put potential investors on notice that the indemnification is not limited, and instead applies to fees and damages incurred in defending a claim brought by the subscribing indemnitor herself. The placement of the indemnifying language, as well as the language itself, must reveal its scope.

A person who contracts to pay an opponent's attorneys' fees if she sues unsuccessfully is agreeing to a departure from the standard American rule that a party prevailing in a lawsuit is not entitled to recover fees from the loser. See *Alyeska Pipeline Service Co. v. Wilderness Society,* 421 U.S. 240, 247, 95 S.Ct. 1612, 1616, 44 L.Ed.2d 141 (1975). It is not too much to ask that a clause effectuating such a deviation from the norm be explicit. The indemnification clause here is worded most peculiarly if its purpose was to shift fees in a 10b-5 case brought by the subscribing investor. The clause nowhere states that, if the investor breaches a warranty in suing the sellers, and loses,

then the investor must pay the defendants' fees. Instead, it promises that the investor will indemnify the sellers from any losses, including attorneys' fees, arising from untruth of any of the warranties signed by the investor--warranties with the stated purpose of preserving the private placement exemption.

The defendants' position is that the expressed intent of the parties, as literally set forth in the indemnification clause, was to force the investors to reimburse the sellers for *all* costs and liability resulting from *any* breach of the representations and warranties. The language thus encompasses this case, they argue. But if the indemnity clause is so interpreted to apply to the plaintiffs' lawsuit for oral misrepresentations, its literal terms would require the plaintiffs to pay the defendants' judgment and attorneys' fees even if plaintiffs prevailed! In our view, the absurdity of such a result--an investor would have a meaningless right to sue, because she would have to pay the judgment and fees of the losing sellers--undermines the reasonableness of the defendants' interpretation of the indemnification.

The defendants respond by pointing out that Section 29 of the Securities Act of 1934, 15 U.S.C. § 78cc (1988) (and its counterpart in the 1933 Act, Section 14, 15 U.S.C. § 77n (1988)) would prohibit a culpable defendant from recovering his losses from the indemnitor plaintiff, thereby eliminating the danger of a successful investor having to reimburse herself. This argument misses the point. We do not suggest that courts would, in fact, require a successful investor litigant to pay her own recovery. The point is simply that, read as the defendants urge, the clause would seem to require that absurd result. That fact suggests to us that the indemnification clause cannot be given the broad

reading that the defendants urge. It further suggests that a reasonable investor would not so interpret the language in agreeing to the clause.[5]

In light of these considerations, we conclude that the indemnification required by the clause in this case does not extend to fees or damages incurred in defending claims brought by the subscribing indemnitor. We therefore affirm the district court's refusal to award attorneys' fees under this clause.

BRYANT'S CHALLENGE TO THE DISTRICT COURT'S REFUSAL TO AWARD FEES UNDER SECTION 11(e) OF THE SECURITIES ACT OF 1933 AND RULES 11 AND 37(c) OF THE *FEDERAL RULES OF CIVIL PROCEDURE*

In addition to joining the main counterclaim, defendant Frank Bryant brought a counterclaim for his attorneys' fees based on Section 11(e) of the Securities Act of 1933, 15 U.S.C. § 77k(e), Rule 11 of the *Federal Rules*

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[5] *Atari Corp. v. Ernst & Whinney*, 981 F.2d 1025, 1031 (9th Cir.1992) (amended opinion), is clearly distinguishable. There the clause in question indemnified "all present and former officers and directors of the Company to the fullest extent permitted by applicable law with respect to all acts and omissions arising out of such individuals' services as officers, directors or employees of the Company or any of its subsidiaries." Nothing in the context narrowed the immense sweep of the indemnifying language. The clause was accordingly held to cover losses caused by an action brought by the indemnitor. In our case, as we explain in the text, the context discloses a narrower purpose.

of Civil Procedure, and Rule 37(c) of the *Federal Rules of Civil Procedure*.[6]

I.

Bryant's Request for Attorneys' Fees Under Section 11(e)

Section 11(e) of the Securities Act of 1933 allows the district court to award attorneys' fees if it "believes the suit or the defense to have been without merit." 15 U.S.C. § 77k(e). "The 'without merit' standard ... encompasses claims and defenses that ... *border on the frivolous.*" *Western Federal Corp. v. Erickson*, 739 F.2d 1439, 1444 (9th Cir.1984) (emphasis added). In its ruling on the defendants' requests for attorneys' fees, the district court stated that, "with respect to some of the claims against Mr. Bryant, McGuiness, [and] Central Bank, that they were--bordered on frivolous." The district court did not award Bryant attorneys' fees under Section 11(e), however, stating that "[w]ith respect to Section 11(e), the standard announced by the 9th Circuit is ... frivolous and brought in

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[6] "We review the district court's rulings on Rule 11 issues under an 'abuse of discretion' standard." *Townsend v. Holman Consulting Corp.*, 929 F.2d 1358, 1365-66 (9th Cir.1990) (en banc). In addition, we review a district court's decision whether or not to award attorneys' fees for abuse of discretion. *Lange v. Penn Mutual Life Insurance Co.* 843 F.2d 1175, 1184 (9th Cir.1988); *Falstaff Brewing Corp. v. Miller Brewing Co.*, 702 F.2d 770, 784 (9th Cir.1983). "However, a district court abuses its discretion if it rests its conclusion on an erroneous legal premise, and questions of law are reviewed de novo." *FSLIC v. Sahni*, 868 F.2d 1096, 1097 (9th Cir.1989); see also *Cooter & Gell v. Hartmarx Corp.*, 496 U.S. 384, 405, 110 S.Ct. 2447, 2460, 110 L.Ed.2d 359 (1990); *Cunningham v. County of Los Angeles*, 879 F.2d 481, 487 (9th Cir.1988), *cert. denied*, 493 U.S. 1035, 110 S.Ct. 757, 107 L.Ed.2d 773 (1990).

bad faith.... I didn't think that these claims fall within that category." As Bryant correctly points out, the district court applied an incorrect legal standard to his request for attorneys' fees; the court apparently believed that it had the discretion to award fees only if the claims against Bryant were frivolous, when in fact it could award fees for those that merely bordered on the frivolous. In light of this error, we remand for a determination of *which* claims bordered on the frivolous, and we direct the district court to consider awarding Bryant the attorneys' fees he incurred in defending against those claims.[7]

II.

Bryant's Request for Attorneys' Fees Under Rule 11

Bryant suggests that the district court applied an erroneous legal standard in rejecting his request for attorneys' fees under Rule 11 of the *Federal Rules of Civil Procedure*. He states that the district court applied the standard articulated in the panel decision of *Townsend v. Holman Consulting Corp.*, 881 F.2d 788, 795 (9th Cir.1989) (Rule 11 sanctions appropriate only when all claims against all parties are frivolous), and that the district court's alleged reliance on *Townsend* constituted reversible error in light of the en banc court's rejection of the panel's opinion. *Townsend v. Holman Consulting Corp.*, 929 F.2d 1358 (9th Cir.1990) (en banc) (frivolous claims can be sanctioned

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[7] Bryant also challenges the district court's finding that the plaintiffs' claims against him were not frivolous. Bryant does not point to any error of law but rather disputes the district court's conclusion that, though some claims bordered on the frivolous, none of them were frivolous. We conclude that the district court did not abuse its discretion in so finding.

even if pleading contains non-frivolous claims). The problem with Bryant's argument is that we have no reason to believe that the district court relied on the *Townsend* panel decision. The district court, in rejecting Bryant's Rule 11 request for fees, correctly outlined the standard for awarding fees under Rule 11 (omitting any reference to a requirement that all claims must be frivolous) and then stated that "I don't think that any of the claims made here rise to that level." The court's use of "any" indicates that it did not apply the *Townsend* panel's ruling, and that it concluded that *each* of the claims was neither frivolous nor brought for an improper purpose. The court did not abuse its discretion in so concluding. We therefore reject Bryant's challenge to the district court's refusal to award fees under Rule 11.

III.

Bryant's Request for Attorneys' Fees Under Rule 37(c)

Bryant asserts that the district court applied an incorrect legal standard in refusing to award him fees under Rule 37(c) of the *Federal Rules of Civil Procedure*; he suggests that the district court followed the plaintiffs' erroneous contention that they could not be penalized for their refusal to admit ultimate issues of fact. Bryant misreads the district court's ruling. The district court did not indicate that it adopted the plaintiffs' position, nor did it appear to follow an incorrect legal standard. We find no abuse of discretion in the court's ruling. We therefore reject Bryant's contention that the district court erred in refusing to award attorneys' fees under Rule 37(c).

CONCLUSION

We affirm the district court's refusal to grant attorneys' fees under the indemnification clause of the subscription agreement. We also affirm the district court's denial of Bryant's request for attorneys' fees under Rules 11 and 37(c) of the *Federal Rules of Civil Procedure*. We remand to the district court Bryant's request for attorneys' fees under Section 11(e) of the Securities Act of 1933, so that the court can apply the proper standard.

All parties except defendant-appellant Bryant are to bear their own costs on this appeal. Bryant is entitled to recover his costs from plaintiffs.

AFFIRMED IN PART, REVERSED IN PART, AND REMANDED.

KOZINSKI, Circuit Judge, dissenting for the most part: The right to make contracts is more than just a socially useful convention; it's an important aspect of personal autonomy. By contract, we can order some of the most important aspects of our existence: housing, health care, education, the pursuit of a profession or vocation, sometimes even marriage. Having the power to bind ourselves in exchange for similar concessions from others gives us a significant measure of control over our lives.

Signing a contract does not, of course, guarantee we will be better off. A system of mutual, free exchange gives us only the opportunity to better ourselves; business acumen, diligence and luck will affect the final tally. The right to contract therefore means the right to take chances, to play hunches, to make mistakes; it means having to live by our decisions, no matter how they turn out: "Wise or not, a deal is a deal." *United Food & Commercial Workers*

Union v. Lucky Stores, Inc., 806 F.2d 1385, 1386 (9th Cir.1986).

While my colleagues don't quarrel with these principles, they do much to undermine them. Confronted with a contract clause they find unpalatable, they refuse to enforce it under the guise of interpretation. But the reasons they offer are not merely unpersuasive; they're transparent. The clause in question says precisely what the sellers claim: It entitles them to attorney's fees for litigation arising out of misrepresentations by the subscribers as to what they did and did not rely on. Reasonable minds can differ as to whether such a clause violates public policy; I believe it does not, but the contrary view is certainly defensible. See pp. 1357-58 *infra*. Less defensible is ducking the issue by twisting the law of contract beyond recognition. Because I cannot agree with the majority's result, and because I see nothing but mischief growing from the way it gets there, I dissent from all but minor portions of the opinion.

A. We must decide whether the following language in the subscription agreement means what it says:

> The Subscriber hereby agrees to indemnify ... the Sellers ... against any losses, claims, damages, liabilities, expenses (including attorneys' reasonable fees and disbursements) ... resulting from the untruth of any of the warranties and representations contained herein, or the breach by the Subscriber of any of the covenants made by him herein.

The majority concedes that "viewed in isolation" this provision could expose the subscribers to liability for the sellers' attorney's fees. Maj. op. at 1351. It's hard to reach any other conclusion:

(1) The subscribers made several warranties, among them that they wouldn't rely on any oral representations in entering the agreement.

(2) They then brought this lawsuit claiming that they in fact *did* rely on oral representations.

(3) The sellers were required to defend the lawsuit at considerable expense because the subscribers lied when they warranted they wouldn't rely on oral representations.

(4) The indemnity clause holds sellers harmless for losses "including attorney's reasonable fees and disbursements ... resulting from the untruth of any of the warranties."

(5) The sellers' expenses (consisting largely of attorney's fees) seem to be exactly what the quoted language covers.

Q.E.D.

Recognizing that the quoted language "could be read so broadly," *id.*, the majority nonetheless concludes that it unambiguously provides the contrary. Indeed, "no rational trier of fact could attribute to the clause the [contrary] meaning urged by the defendants." *Id.* at n. 3. The majority thus holds that a trier of fact would have to be drunk or crazy to construe the contract to mean what it says.

California law is just the opposite. If the language of a contract is susceptible to two different meanings, each side is entitled to put on evidence supporting its preferred

construction. *See, e.g., Pacific Gas & Elec. Co. v. G.W. Thomas Drayage & Rigging Co.,* 69 Cal.2d 33, 37, 69 Cal.Rptr. 561, 442 P.2d 641 (1968). Even if the language seems susceptible to only one meaning, a party may still put on evidence that a second meaning reflects the parties' actual intent. *Id.* at 39-40, 69 Cal.Rptr. 561, 442 P.2d 641; see also *Brinderson-Newberg Joint Venture v. Pacific Erectors, Inc.,* 971 F.2d 272, 276-77 (9th Cir.1992) (following *Pacific Gas*). I don't understand how we can deny the sellers a trial to prove that the parties in fact intended that the clause "be read so broadly." Maj. op. at 1351.

B. But why does the majority so categorically reject the plain language of the contract? The indemnification clause follows language, the majority explains, which suggests the warranties were made to ensure compliance with the private placement exemption to the federal securities laws. Maj. op. at 1351. For example, each subscriber agreed not to transfer his shares, as required by Rule 506, the exemption relied on here. See 17 C.F.R. §§ 230.506, 230.502(d). Assuring compliance with the securities laws was no doubt the reason for some of the warranties.

Many other warranties do not track the rule, however. Investors in private placements need only be worth $1 million, whereas each subscriber here warranted he had a net worth of at least $5 million. *Id.* § 230.501(a)(5). The subscribers also said they understood the financial statements were unaudited, even though the SEC rules don't require audited statements for Rule 506 offerings, nor any such warranties by subscribers. *Id.* § 230.502(b). Similarly, each investor warranted he had read the offering memorandum, and that the books and accounts of the company were available to him; the regulations state that "[t]he issuer is

not required to furnish [such information] to any accredited investor," *id.* § 230.502(b)(1), which all of these subscribers were. Clearly the sellers sought and obtained warranties beyond those required by the securities laws.

Most telling is the warranty at issue here--that the subscribers weren't relying on representations made outside the offering materials. One searches in vain for this requirement in Rule 506 or anywhere else in the securities laws. How does this dovetail with the majority's conclusion that the warranties served no purpose other than to protect the private placement exemption? What becomes of this warranty under the majority's approach? Are we free to interpret the contract--and declare that no rational trier of fact could do otherwise--so as to render this warranty a nullity?

Left to my own devices, I'd just read the disputed language as written. But if we're going to triangulate the meaning of the indemnity clause by reference to neighboring clauses, surely we must look at all such clauses. The majority does the sellers an injustice by failing to even acknowledge these other provisions.

C. The majority also maintains the indemnity provision wasn't specific enough to put the subscribers on notice. See Maj. op. at 1351-52. It relies on *Zissu v. Bear, Stearns & Co.*, 805 F.2d 75, 79-80 (2nd Cir.1986), for the proposition that the subscribers weren't fairly apprised they could be liable for attorney's fees if their securities suit was unsuccessful. But the indemnity clause at issue in *Zissu* only provided for indemnity "against *any and all loss*, damage or liability due to or *arising out of a breach* of any representation or warranty." *Id.* at 77 (emphasis supplied by *Zissu*). Accordingly, *Zissu* refused to enforce the agreement

because "no mention of attorneys' fees was made in the indemnification clause." *Id.* at 79. The Second Circuit left room for the use of such a clause, but held that "a higher level of specificity is required when attorneys' fees are being assessed against a plaintiff suing for securities fraud." *Id.* at 80.

Here we have just such a higher level of specificity: Every subscriber agreed to indemnify the sellers "from and against any losses, claims, damages, liabilities, [and] expenses (*including attorneys' reasonable fees and disbursements*) ... resulting from the untruth of any of the warranties" (emphasis added). The lack of notice that troubled the Second Circuit in *Zissu* just isn't a problem here. See *Barnebey v. E.F. Hutton & Co.*, 715 F.Supp. 1512, 1519-22 (M.D.Fla.1989).

More fundamentally, I question the majority's solicitude for these subscribers. These weren't mom and pop investors who mortgaged their retirement to buy palladium mines in Zanzibar. They weren't forced into the contract by economic duress; they weren't badgered by salesmen who pounded down their doors on Saturday morning. These were seasoned business people who commanded considerable resources. Many of them had substantial experience with horse breeding; some had already been doing business with Spendthrift.[1] Most retained independent investment

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[1] Typical is Robert Stratmore, an attorney who specialized in equestrian law and transactions, who grossed more than $15 million in thoroughbred trading the year of the Spendthrift offering and who holds lifetime breeding rights to Triple Crown winner Seattle Slew. See VII Joint ER, tab 20, exh. Q, at 149, 192. As defendants point out in their briefs, other subscribers included international fashion mogul Calvin

(continued...)

advisers and lawyers, and took their sweet time buying into the deal.[2] They risked what they warranted were disposable resources, hoping to get even richer. They gambled--and they lost.

Under these circumstances, what on earth does it mean to say the subscribers didn't have notice of the attorney's fee indemnity clause? It's axiomatic that a contract gives its signatories notice of what it says. We may blunt the cutting edge of this principle when one of the parties is illiterate, or subject to economic duress, or when we see legal filigree buried deep within a long, printed contract. But what justifies departing from this principle

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[1](...continued)
Klein; Zenya Yoshida, Japan's largest and most prominent horse breeder; and the Layman family, who has been involved with thoroughbred horses for over thirty years. See Defendants' Brief at 8 & n. 4.

[2] For example, Barry Schwartz asked his lawyer and investment advisor, Ralph Finerman, to review the PPM. IV Joint ER, tab 19, exh. D, at 20, 99, 103. Attorney Finerman holds a masters degree in taxation and is a CPA. *Id.* at 12. Finerman first heard about the Spendthrift placement on June 20, 1983, and began reviewing the documents the next day. Id. at 99, 103. Finerman carefully studied the agreement, *id.* at 103, and had several conversations with persons at Spendthrift about the deal, *id.* at 104-05. Finerman discussed the fruits of his research thoroughly with Schwartz before advising him to sign onto the deal. *Id.* at 118. Although Finerman made an initial, tentative decision around July 1st, 1983, VIII Joint ER, tab 22, exh. I, at 144, Schwartz didn't sign the agreement until July 13, 1983, three weeks after first receiving it. I Joint ER, tab 4, at 3. See also V Joint ER, tab 20, exh. F (George E. Layman, Jr., reviewed the deal with both an attorney and an accountant); IV Joint ER, tab 19, exh. E (Earl Schultz had two legal advisors, as well as the legal department of one of his companies, review the transaction before signing); VI Joint ER, tab 20, exh. P (Zenya Yoshida's attorney approved the deal).

here? If these subscribers can't be held to the terms of the contract they signed, who ever can?

D. We get a glimpse of what animates the majority's legal aerobics in the part of the opinion where they dispatch the sellers' suggested interpretation: "But if the indemnity clause is so interpreted to apply to the plaintiffs' lawsuit for oral misrepresentations, its literal terms would require the plaintiffs to pay the defendants' judgment and attorney's fees even if plaintiffs prevailed!" Maj. op. at 1352. The majority twice describes this as an absurd result, but nowhere really explores the issue. Which is too bad, because this is the meat of the coconut--the difficult public policy question at the heart of this dispute.

Before addressing this issue, however, I note that the majority does more than interpret the contract. By twice labelling the result suggested by the sellers as "absurd," the majority is saying it wouldn't enforce the clause even if the contract clearly and unambiguously provided what the sellers claim it does, and even if it gave ample notice to the subscribers. An absurd result, after all, remains absurd even if it's explicitly enshrined in the contract. The majority thus writes off what might be a perfectly acceptable and useful provision in a private placement agreement without even a close look. It would be far better if the majority confronted the issue squarely.

The majority's error begins and ends with its phrasing of the issue. After all, if you *assume* a securities law violation, it makes no sense to suggest that a defrauded plaintiff will have to indemnify the defrauding defendant by paying back the 10b-5 judgment plus attorneys' fees. But the whole purpose of a provision like the one we are construing is to forestall a 10b-5 violation by limiting the

information the investors rely on. Properly framed, the critical question here is: May sophisticated, well-counselled parties, using disposable assets, dealing at their leisure and from arms' length, limit by contract what information they will consider in making a major investment?

A perfectly respectable argument can be made that such a provision runs afoul of section 29(a) of the Securities Exchange Act of 1934, which states that "[a]ny condition, stipulation, or provision binding any person to waive compliance" with the federal securities laws and regulations is void. 15 U.S.C. § 78cc(a); see also *id.* § 77n. Enforcement of the indemnity provision could be seen as a waiver of the securities laws because it bars securities lawsuits based on misstatements of fact not contained in the offering materials. Rule 10b-5, after all, prohibits "any untrue statement of a material fact ... in connection with the purchase or sale of any security," not merely those made in the private placement memorandum. 17 C.F.R. § 240.10b-5 (emphasis added). Giving effect to the indemnity clause might prevent a meritorious securities action based on misrepresentations made by the promoters orally or in writings outside the formal offering package. An indemnity clause could thus be viewed as an end-run around the securities laws.

In fact, it's the very opposite. The whole point of requiring a written prospectus that conforms to the SEC's precise guidelines, see Reg.D, 17 C.F.R. §§ 230.501-.508, is to ensure that the parties rely on unbiased written data, not on half-whispered oral representations. Letting parties warrant that they are relying only on those offering materials serves this policy admirably: It forces potential subscribers to look closely at the written materials and avoids the

ambiguity and claims of fraud inevitably fostered by collateral oral promises. The warranty, moreover, focuses on reliance, the key element in establishing liability under Rule 10b-5. See *Basic, Inc. v. Levinson,* 485 U.S. 224, 243, 108 S.Ct. 978, 989, 99 L.Ed.2d 194 (1988) (misstatements lead to liability only if they're relied on); *Ernst & Ernst v. Hochfelder,* 425 U.S. 185, 206, 96 S.Ct. 1375, 1387, 47 L.Ed.2d 668 (1976) (same). Reliance is, by its nature, subjective; it's easily fabricated or distorted, particularly after the deal sours. Letting parties agree about what they will and will not consider in making a sophisticated, face-to-face securities investment would avoid the cost, uncertainty and delay of securities litigation that now turns on inherently unknowable mental processes.

Much is at stake here for everyone involved. This litigation--although it resulted in a complete defense victory, mostly on summary judgment--devoured a staggering quantity of productive resources. The record consists of 50 cubic feet of paper and weighs over half a ton. There were 4500 entries in the docket sheets below, including almost 400 orders and rulings by the district court. Fifty-seven briefs, consisting of nearly 1800 pages, were filed on appeal, yielding three published opinions. See *Schultz v. Hembree,* 975 F.2d 572 (9th Cir.1992); *McGonigle v. Combs,* 968 F.2d 810 (9th Cir.1992). Some 200 attorneys contributed to this conflagration, supported by legions of paralegals, summer associates and other staff. The attorneys' fees, for the seven defendants who requested them, amounted to more than $3.5 *million*. This says nothing of the fees incurred by the 13 plaintiffs and the 14 defendants who didn't request reimbursement; it doesn't take into account other litigation expenses such as photocopying, telephone, facsimile and messenger charges; deposition transcripts;

airfares, limousines and hotel rooms; power meals in swank restaurants. *See generally* Lisa Gibbs, *Skadden Calls Fee Routine; Florida Calls It Gouging*, American Lawyer, July/Aug.1991, at 19 (billing dispute involving, among other things, a $17 fee for courier delivery of a 75-cent newspaper).

Chasing down ephemeral oral representations may be great fun for the lawyers--and so profitable, too--but it does nothing to ensure the integrity or regularity of our securities markets. To the contrary, fear of this type of scorched earth litigation--the juridical equivalent of the firebombing of Dresden--will only discourage people like the sellers from entering into such transactions. That the plaintiffs were able to inflict major financial damage on their adversaries, using as their launch vehicle a case so thin it was never allowed to reach the jury,[3] will surely send a chill down the spine of anyone contemplating selling securities--or engaging in any other type of business--in our litigation-minded society. Assuming, as we must, that our national interest is served when financial markets function efficiently, unbeclouded by the risk of kamikaze litigation, a clear statement that we *will* enforce a subscriber's warran-

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[3] The case of Frank Bryant, a Spendthrift consultant, is particularly alarming. His defense was that he joined Spendthrift *after* the sale of the shares and was not in any way involved in the conception or drafting of the PPM. See e.g., X Joint ER, tab 28 (Declaration of Frank L. Bryant in Support of his Motion for Summary Judgment or Summary Adjudication of Issues). Defending on this theory, and winning summary judgment, Bryant was nonetheless saddled with approximately $900,000 in legal fees. See Declaration of Thomas K. Bourke in Support of Bryant's Motion for Award of Attorney's Fees from Casares and Schultz at 3-4. If this is the face of victory, how much uglier could defeat be?

ty he hasn't considered matters outside the offering materials would have an entirely salutary effect.

Doing so would inflict no injustice. The subscribers were sophisticated and obviously wielded substantial bargaining power. They got legal and financial advice galore before committing to the deal. See nn.1-2 supra. Had they relied on oral representations made by the sellers, they could (and should) have said so before the money was paid and the securities delivered. See Henry Klehm III, *Comment, Contractual Shifting of Defense Costs in Private Offering Securities Litigation,* 136 U.Pa.L.Rev. 971, 998-1002 (1988). I see no reason in the language or policies of the securities laws to make for them a softer bed than they've made for themselves.

That's why the majority's twice-asserted declaration of absurdity is entirely beside the (exclamation) point. Of course it would violate public policy, as well as the express terms of section 29(a), for parties to agree to pay back any damages they suffer under the securities laws. But it isn't nearly so absurd--indeed it makes considerable sense--to let parties limit by contract what they will and will not take into account when negotiating sophisticated financial transactions. The majority dismisses a lawful and potentially beneficial device by the use of a punctuation mark.

Conclusion

I agree that the district court applied an incorrect legal standard in ruling on Frank Bryant's request for attorneys' fees pursuant to section 11(e) of the Securities Act of 1933; accordingly, I concur in remanding for a determination of which claims the district court believes bordered on the frivolous. I also agree that the district court didn't abuse its discretion in refusing to award Bryant fees

under *Fed.R.Civ.Proc.* 11 and 37(c). But I strongly disagree with, and therefore dissent from, everything else in the majority opinion.

APPENDIX B

Robert D. STRATMORE, Plaintiff,

v.

Leslie COMBS II, et al., Defendants.
George E. LAYMAN, et al., Plaintiffs,

v.

Brownell COMBS II, et al., Defendants.
H. James GRIGGS, Plaintiff,

v.

Brownell COMBS II, et al., Defendants.
Zenya YOSHIDA, Plaintiff,

v.

Brownell COMBS II, et al., Defendants.
Fred L. FREDERICKS, Plaintiff,

v.

Brownell COMBS II, et al., Defendants.
John S. McGONIGLE, Plaintiff,

v.

Leslie COMBS II, et al., Defendants.
CENTRAL BANK AND TRUST COMPANY, Plaintiff,

v.

John F. McGONIGLE, et al., Defendants.
HAMILTON PARTNERS, et al., Plaintiffs,

v.

Leslie COMBS II, et al., Defendants.
Blas R. CASARES, Plaintiff,

v.

Brownell COMBS II, et al., Defendants.
Richard D. SCHULTZ, Plaintiff,

v.

Leslie COMBS II, et al., Defendants.

SPENDTHRIFT FARM, INC., Plaintiff,

v.

John F. McGONIGLE, et al., Defendants.

CONTINENTAL CASUALTY COMPANY, Plaintiff,

v.

Frank L. BRYANT, et al., Defendants.

Richard D. SCHULTZ, Plaintiff,

v.

Bateman EICHLER, et al., Defendants.

Russell E. CARLISLE, Plaintiff,

v.

SPENDTHRIFT FARM, INC., Defendant.

NORTHWOOD THOROUGHBRED INVESTORS, et al., Plaintiffs,

v.

Charles R. HEMBREE, Defendant.

Nos. C-86-0379-CAL, C-86-1692-CAL, C-86-3474-CAL, C-86-3673-CAL, C-86-3829-CAL,C-86-4129-CAL, C-86-6453-CAL, C-87-0228-CAL, C-87-1129-CAL, C-87-6038-CAL, C-88-0451-CAL, C-88-2577-CAL, C-88-3175-CAL, C-89-1342-CAL and C-89-1915-CAL.

MDL No. 710.

United States District Court,

N.D. California.

Sept. 28, 1989.

Vaughn R. Walker, Pillsbury, Madison & Sutro, San Francisco, Cal., and Stephen M. O'Brien III, Landrum, Shouse & Patterson, Lexington, Ky., for George E. Layman, et al., H. James Griggs and Zenya Yoshida.

John I. Alioto, Alioto & Alioto, San Francisco, Cal., for Robert D. Stratmore and John F. McGonigle.

Thomas E. Kotoske, Palo Alto, Cal., for Frederick L. Fredericks and Richard D. Schultz.

Kay S. Kuns, Santa Ynez, Cal., for Frederick L. Fredericks.

Richard M. Trautwein, Barnett & Alagia, Louisville, Ky., for Blas R. Casares.

Timothy L. Bouscaren, Benesch, Friedlander, Coplan & Aronoff, Cincinnati, Ohio, for Hamilton Partners.

Richard D. Rogovin and Robert D. Jacobs, Bricker & Eckler, Columbus, Ohio, for Richard D. Schultz.

Curt H. Mueller, Cooley, Godward, Castro, Huddleston & Tatum, San Francisco, Cal., and Lawrence Pedley, Pedley, Ross, Zielke & Gordinier, Louisville, Ky., for Brownell Combs, II.

Richard Haas, Lasky, Haas, Cohler & Munter, San Francisco, Cal., for Leslie Combs, II.

Boake Christense, McCutchen, Doyle, Brown & Enersen, San Francisco, Cal., and Jack G. Jones, Jr., Wyatt, Tarrant & Combs, Lexington, Ky., for Richard F. Broadbent, III and Bloodstock Research and Statistical Bureau.

Steven M. Umin, Williams & Connolly, Washington, D.C., for Bloodstock Research Information Services, Inc.

M. Laurence Popofsky, Heller, Ehrman, White & McAuliffe, San Francisco, Cal., for Charles R. Hembree and Kincaid, Wilson, Schaeffer & Hembree, P.S.C.

Ann G. Daniels and, Jerome I. Braun, Farella, Braun & Martel, San Francisco, Cal., for Spendthrift Farm, Inc. and Central Bank & Trust of Lexington.

Thomas K. Bourke, Riordan & McKinzie, Los Angeles, Cal., for Frank L. Bryant.

James E. Burns, Jr., Brobeck, Phleger & Harrison, San Francisco, Cal., for Bateman Eichler, Hill Richards, Inc. and Robert J. McGuinness.

Garth Guy, Columbus, Ohio, in pro. per.

Robert C. Vanderet, O'Melveny & Myers, Los Angeles, Cal., for Gibson, Dunn & Crutcher.

OPINION AND ORDER

LEGGE, District Judge.

These consolidated cases arose from the sale of securities of Spendthrift Farms, Inc. by certain defendants to plaintiffs in a private placement transaction. The complaints asserted claims under the federal securities laws, state securities laws, and common law. After extensive pretrial and trial proceedings, summary judgments or directed verdicts were granted in favor of some defendants, and the jury found in favor of the remaining defendants.

Some defendants counterclaimed against plaintiffs for the attorneys' fees they incurred in the defense of these cases, and they now move for summary judgment on those claims. Defendants Brownell Combs, II and Garth Guy

move to file similar counterclaims. Plaintiffs oppose those motions and themselves move for summary judgment against the counterclaims.

The issue addressed in this opinion is whether defendants can recover their attorneys' fees from plaintiffs under the terms of the Subscription Agreement, the document under which plaintiffs purchased their shares of Spendthrift.[1] This court has already denied defendants' motions and granted plaintiffs' motions in open court. This opinion is to record the court's reasons for that decision.[2]

I.

When plaintiffs expressed their interest in purchasing shares of Spendthrift, they received a lengthy private placement memorandum. The private placement memorandum included the Subscription Agreement. Those plaintiffs who purchased shares of Spendthrift were required to execute the Subscription Agreement and deliver it to Spendthrift and to the selling stockholders.

In paragraph number four of the Subscription Agreement, the purchasing plaintiffs were required to represent and warrant twenty-two facts and legal conclusions, spread over three pages of single spaced type. Construed as a whole, the representations and warranties were obviously intended to enable Spendthrift and the

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[1]There are no genuine issues of material fact in these motions. The decisions are made by construing the Subscription Agreement and by applying statutory and case law.

[2]Defendants also moved to recover their attorneys' fees under certain statutory provisions and under common law. This court has made a separate ruling on those motions, and they are not the subject of this opinion.

selling stockholders to preserve the private placement exemption under the Securities Act of 1933. However, some of the representations and warranties go beyond that objective.

Paragraph four is followed by an indemnification clause. That indemnification clause is what is at issue in these motions. The clause states as follows:

> 5. *Indemnification*. The foregoing representations and warranties are made by the Subscriber [plaintiff] with the intent that they may be relied upon in determining his qualification and suitability to purchase Shares, and the Subscriber [plaintiff] hereby agrees that such representations and warranties shall survive his purchase thereof. *The Subscriber [plaintiff] hereby agrees to indemnify and hold harmless* the Company, the Sellers and agents of each of them [defendants] *from and against any losses, claims, damages, liabilities, expenses (including attorneys' reasonable fees and disbursements)*, judgements and amounts paid in settlement *resulting from the untruth of any of the warranties and representations contained herein*, or the breach by the Subscriber [plaintiff] of any of the covenants made by him herein. Notwithstanding the foregoing, however, no representation, warranty, acknowledgement or agreement by the Subscriber [plaintiff] made herein shall in any manner be deemed to constitute a waiver of any rights granted to him under Federal or State securities laws.

(Emphasis added). Defendants contend that by virtue of that clause they are entitled to recover from plaintiffs the reasonable attorneys' fees and costs incurred by defendants in their successful defense of this litigation. Defendants assert that, as a result of the judgments in defendants' favor and the testimony given by plaintiffs during the trial, plaintiffs have breached some of the representations and warranties contained in paragraph four. And defendants point to the provision of the indemnification clause which expressly provides for the recovery of reasonable attorneys' fees and disbursements.

The court need not discuss each of the representations of warranties which were allegedly breached by plaintiffs during the course of this litigation. Some of the breaches are admitted. And the court will assume that the representations or warranties alleged by defendants were breached by plaintiffs. The court does note, however, that the breaches did not result in the loss of the private placement exemption. Defendants' claims are not based on any loss of that exemption, but instead defendants seek to recover their attorneys' fees and costs incurred in the successful defense of these cases.

II.

In general, contracts for indemnity and the recovery of attorneys' fees and costs are enforceable. *Wagner v. Benson,* 101 Cal.App.3d 27, 36, 161 Cal.Rptr. 516, 522 (1980); *Michael-Regan Co., Inc. v. Lindell,* 527 F.2d 653, 656-58 (9th Cir.1975). The problem here is that this general principle of enforceability overlaps with, and indeed conflicts with, a policy of the federal securities laws expressed by both statutes and case law. That policy is to preserve the power of securities purchasers to enforce their

rights under the securities laws. As a result of that policy, courts have approached with caution agreements which could waive or restrict those rights of enforcement. Research has disclosed no authority in this circuit which directly resolves this conflict.

This court concludes that the indemnity agreement at issue here does not encompass the right of defendants to recover their attorneys' fees expended in their successful defense. The court reaches that conclusion by interpretation of the indemnity clause itself, and by the application of the federal policy. This court does not conclude that *no* indemnity agreement could *ever* shift the expenses of a successful defense to securities plaintiffs. Rather, this decision is based upon the court's interpretation of *this* indemnity agreement, against the backdrop of the public policy expressed by the statutes and the cases.

III.

First, the language of the indemnity clause itself:

As stated, the representations and warranties made in paragraph four--the breach of which triggers the indemnification clause in paragraph five--are primarily intended to preserve the private placement exemption. That intent is not derived just from paragraph four, but also from the first sentence of the indemnification clause. It states that the representations and warranties are made "with the intent that they may be relied upon in determining [plaintiff's] qualification and suitability to purchase shares." This language is to protect Spendthrift and the selling shareholders from the consequences of a plaintiff being unqualified, or the shares being unsuitable for his investment, and hence the private placement exemption being lost.

The indemnity clause is also sensitive to not requiring the purchasers to waive their rights under the federal or state securities laws. This is stated in the last sentence of the clause, which provides that in spite of the agreement to indemnify,

> "no representation, warranty, acknowledgment, or agreement by [plaintiff] made herein shall in any manner be deemed to constitute a waiver of any rights granted to him under Federal or State securities laws."

The sentence can be interpreted as meaning that if a purchaser does sue for alleged violations of the securities laws, all rights and remedies would be governed by those laws and not by the terms of the indemnity clause. That is a reasonable interpretation in light of the statutory and case law which the court will now discuss.

IV.

Under section 14 of the Securities Act of 1933, 15 U.S.C. § 77n, securities purchasers cannot waive the sellers' compliance with the securities laws. The last sentence of this indemnification clause preserves that position, and the clause is expressly not such a waiver. In light of that statutory provision, courts have been careful in securities cases to preserve the rights of private action under the securities laws. But the results have not been uniform.

Some cases have enforced indemnity clauses in litigation involving securities. The court in *Tartell v. Chelsea National Bank*, 351 F.Supp. 1071, 1079 (S.D.N.Y.1972) *aff'd*, 470 F.2d 994 (2d Cir.1972) (*per curiam*), enforced an attorneys' fees provision against the maker of a note who had unsuccessfully sued the lender for

securities fraud. And the court in *Samuels v. Wilder,* 871 F.2d 1346 (7th Cir.1989), enforced an indemnity clause which read:

> The Owner [plaintiff] agrees to indemnify the Nominee, his successors, and assigns, and to hold Nominee harmless from all liability, loss, expenses, damages, costs and attorney's fees that Nominee may at any time incur by reason of any type of inquiry, action or suit which may be brought against him or made of him by any person, firm, corporation, or governmental agency or authority or anyone else by reason of the nomineeship.

Id. at 1348. The *Samuels* court, applying state law and without discussing federal securities law, interpreted the clause as a standard indemnity provision and required plaintiff to reimburse the Nominee for the attorneys' fees it spent defending plaintiff's action for securities fraud and misrepresentation. *Id.* at 1352. To the extent that *Tartell* and *Samuels* involved interpretation of the language of specific indemnity clauses, they are of course not controlling on the clause at issue here.

The strongest position against enforcement of such indemnity provisions was stated in *Doody v. E.F. Hutton & Co.,* 587 F.Supp. 829 (D.Minn.1984). The plaintiffs represented in purchasing the securities that they had relied only upon the offering documents. They then sued under the securities laws for alleged oral misrepresentations, and were unsuccessful. The subscription agreement contained the following indemnity clause:

> [each plaintiff agreed] to indemnify and hold harmless the Partnership, the General Partner, its affiliates and participating broker-dealers from and against all damages, losses, costs and expenses (including reasonable attorneys' fees) which they may incur by reason of ... any breach of the representations and warranties made by the undersigned herein....

Id. at 831. The *Doody* court held:

> The Court finds that enforcing an indemnity provision such as the one in the instant action would discourage prospective plaintiffs from bringing securities fraud actions whenever there is an integration clause in a subscription agreement. Prospective plaintiffs would be discouraged because the plaintiffs would be running the risk of incurring substantial liability for attorneys' fees and costs. *Since the securities laws are a remedial measure intended to encourage the prosecution of securities fraud actions, the Court refuses to enforce this indemnity provision.*

Id. at 833 (emphasis added).

Other courts have not taken such an absolute stance, recognizing a seller's legitimate interest in receiving accurate information from a buyer, particularly in order to conduct a private placement offering. The court in *Barnebey v. E.F. Hutton & Co.*, 715 F.Supp. 1512 (M.D.Fla.1989), distinguished the *Doody* court's analysis, quoting with

approval the lower court's decision in *Zissu v. Bear Stearns & Co.*:[3]

> [i]f this indemnification agreement is not enforceable, it would undermine the securities laws to the extent that investors would be free to make misrepresentations with impunity and issuers would be wholly unable to accurately assess the qualifications of potential investors in risky ventures such as this one.

Id. at 1522. The *Barnebey* court did not actually give effect to the indemnity provision, however; it denied the plaintiff's motion to declare the indemnity clause unenforceable on public policy grounds.

The most specific case regarding the indemnity at issue here is *Zissu v. Bear, Stearns & Co.*, 805 F.2d 75 (2d Cir.1986). Plaintiff sued under the securities laws, based in part on alleged oral misrepresentations. Plaintiff had warranted in his subscription agreement that he had relied only upon the written offering materials, and he agreed to indemnify and hold defendants harmless "against any and all loss, damage or liability due to or arising out of a breach of any representation or warranty." Plaintiff lost his suit, and defendants counterclaimed for their attorneys' fees based on that indemnity agreement. The *Zissu* court stated that contracts allowing recovery of attorneys' fees in securities suits did not violate the securities laws *per se*. However, the court declined to award defendants their attorneys' fees based on that indemnity agreement. The court explained:

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[3]627 F.Supp. 687 (SD NY1986); but see 805 F.2d 75 (2d Cir.1986).

> The clause *Zissu* signed did not put him on notice that he would be responsible for defendants' legal fees incurred in the security fraud suit. In fact, no mention of attorney's fees was made in the indemnification clause. Instead, the warranties in question were necessary to exempt the limited partnership from the requirements of the 1933 Act and are so understood by investors. That being the case, the parties had little reason to expect that such warranties might also be the basis for the counterclaim made in the present case. Thus, although New York courts have held that contractual indemnity provisions for attorney's fees will be enforced, and broad indemnification provisions like the one here should be read to extend to such fees, *a higher level of specificity is required when attorneys' fees are being assessed against a plaintiff suing for securities fraud.*

Id. at 79-80 (citations omitted) (emphasis added).

A similar position was stated in "*Contractual Shifting of Defense Costs in Private Offering Securities Litigation,*" 136 U.Pa.L.Rev. 971 (1988), in which the author concludes:

> Sellers of private offerings claiming an exemption from the registration provisions of federal securities law should be entitled to enforce indemnification clauses included in the subscription documents in the proper circumstances. To be eligible to do so, the seller must have complied fully with federal

> securities laws, *including disclosing the existence and effect of the indemnification clause.*

Id. at 1002 (emphasis added).

Congress has long provided that the proper balance between protecting investors and promoting capital formation is reached by full disclosure of the risks involved in an investment. Full disclosure is at the heart of the federal securities laws. *Id.* at 974. The same principle should apply in the context of indemnification agreements in securities purchases. Sellers should not be absolutely barred from enforcing by indemnity agreements the warranties and representations made by buyers. However, as the *Zissu* court stated, if those indemnity provisions are to include defendants' attorneys' fees incurred in suit by buyers for securities laws violations, such an inclusion should be very clear.

Defendants here argue that this indemnity clause explicitly mentions attorneys' fees, unlike the one in *Zissu*. Therefore, defendants believe that this indemnity provision was specific. However, the reasoning in *Zissu* went beyond the mere presence or absence of the words "attorneys fees" in the clause. The court pointed out that the main purpose of the warranties and representations was to protect the private placement exemption, as it is here. In that context, plaintiffs had little reason to anticipate that the indemnity provision would apply to suits by the buyers themselves against the sellers for securities act violations.

Finally, as already noted, the last sentence of the indemnity clause provides that plaintiffs do not waive their rights under the securities laws. One of those rights is that they are not liable for attorneys' fees unless their suit is

frivolous. 1933 Securities Act § 11(e), 15 U.S.C. § 77k(e). If the indemnity clause is to impose upon them liability for attorneys' fees on a different basis, that statement should be explicit.

V.

In summary, the court concludes that the indemnity clause here did not explicitly provide that plaintiffs would be liable for defendants' attorneys' fees in the event of an unsuccessful securities law suit by plaintiffs, and the clause therefore may not be enforced in that manner.

IT IS THEREFORE ORDERED that:

1. Defendants' motions for summary judgment to enforce the indemnity clause of the Subscription Agreement are denied;

2. Plaintiffs' motions for summary judgment to preclude enforcement of the indemnity clause are granted; and

3. The motions of defendants Combs and Guy for leave to file counterclaims based upon the indemnity clause are denied.

Dated: September 28, 1989

/s/

CHARLES A. LEGGE
UNITED STATES DISTRICT JUDGE

APPENDIX C
UNITED STATES DISTRICT COURT
EASTERN DISTRICT OF KENTUCKY
LEXINGTON

CIVIL ACTION NO. 90-131

BROWNELL COMBS II, *PLAINTIFF,*

V.

ZENYA YOSHIDA, et al., *DEFENDANTS*

MEMORANDUM OPINION AND ORDER

In 1983, plaintiff Brownell Combs offered to sell 175,000 shares of common stock in Spendthrift Farm Incorporated, a thoroughbred horse farm, to defendant Zenya Yoshida, a Japanese horseman who conducts his thoroughbred business in the United States under the name Shadai Farm. The purchase price for the stock was $1,750,000.00. As part of the transaction, defendant was required to review a "private placement memorandum" and sign a "subscription agreement". This was necessary, in part, to enable Spendthrift to retain its private placement registration exemption under 17 C.F.R. §§ 230.501-508.

One of the conditions of the private placement registration exemption is that any purchaser of the exempt security be "sophisticated" such that the purchaser has: a minimum net worth, knowledge and experience in investment matters, a capability of evaluating the risks and merits of the investment, access to the issuer's books and records, no intent to resell the exempt security, and an opportunity to ask questions and receive answers. 17 C.F.R. §§ 230.501, 502 and 506. The subscription agreement signed by defendants in connection with the sale of Spendthrift stock

contained numerous warranties, several of which mirrored the sophistication requirements. When he signed the subscription agreement, Yoshida warranted, among other things: a) that he had received and read the private placement memorandum; b) that all relevant documents concerning Spendthrift had been made available to him; c) that he could adequately evaluate the merits and risks of his investment in Spendthrift; d) that he understood there were restrictions on the transferability of the stock in Spendthrift; e) that he was not relying on any representations other than those in the private placement memorandum; and, (f) that he understood the financial information in the private placement memorandum was not audited, and that no provision had been made for deferred taxes.

In 1986, Yoshida and others filed a securities fraud lawsuit in the United States District Court for the Northern District of California, against Combs and others, alleging fraud, negligent misrepresentation, and violations of various state and federal securities laws, all in relation to the sale of Spendthrift stock. The suit took eleven weeks to try, and at its conclusion, the jury returned a verdict in favor of Combs and the others named. It is not seriously disputed, and in fact was a finding of the California District Court, that during the course of the California lawsuit, defendant breached several of the warranties contained in the subscription agreement. *Stratmore v. Combs,* 723 F. Supp. 458, 460 (N.D. Cal. 1989).[1]

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[1] For example, in the California suit, defendant alleged that he relied on oral representations made by the sellers when he purchased the Spendthrift stock. However, as part of the subscription agreement, defendant had warranted that he did not rely on any representations other that those contained in the private placement memorandum.

Also during the California suit, many of the named parties counterclaimed for attorneys' fees, costs, and other damages based on an indemnity clause in the subscription agreement. Combs did not initially assert a counterclaim, but after the jury's verdict in the case in chief, he moved to file a counterclaim similar to those asserted by the other parties. In its *Stratmore* opinion, the District Court for the Northern District of California dismissed the existing counterclaims, and denied Combs leave to file his counterclaim. This decision was affirmed by a divided panel of the Ninth Circuit Court of Appeals in *Layman v. Combs*, 981 F.2d 1093 (9th Cir. 1992).

Plaintiff initiated the present suit shortly after the *Stratmore* decision to advance basically the same claims that he attempted to advance by way of counterclaim in California. This action was filed in the Eastern District of Kentucky based in part on plaintiff's assertion that defendant signed the subscription agreement in Fayette County, Kentucky (located within the Eastern District of Kentucky), and that the subscription agreement was accepted by plaintiff in Fayette County.

Recovery of attorneys' fees, costs, and damages is sought by plaintiff under paragraph five of the subscription agreement, referred to as the indemnity clause:

> 5. *Indemnification*. The foregoing representations and warranties are made by the Subscriber with the intent that they may be relied upon in determining his qualification and suitability to purchase Shares, and the subscriber hereby agrees that such representations and warranties shall survive his purchase thereof.

> The Subscriber hereby agrees to indemnify and hold harmless the Company, the Sellers, and agents of each of them from and against any losses, claims, damages, liabilities, expenses (including attorney's reasonable fees and disbursements), judgments and amounts paid in settlement resulting from the untruth of any of the warranties and representations contained herein, or breach by the Subscriber of any of the covenants made by him herein.
>
> Notwithstanding the foregoing, however, no representation, warranty, acknowledgement or agreement by the Subscriber made herein shall in any manner be deemed to constitute a waiver of any rights granted to him under Federal or State securities laws.

Plaintiff claims that as a result of defendant's breaches of the warranties contained in the subscription agreement, he suffered damages, including attorney's fees for the ten-week California suit, in the amount of $101,000,000.00, plus interest[2] Plaintiff also seeks punitive damages in the amount of $200,000,000.00. Named defendants are Yoshida and Shadai Farms (singularly referred to as defendant).

Because of the pendency of the *Stratmore* appeal, this case was initially stayed, and later dismissed without prejudice to refile following a final decision by the Ninth Circuit. When the case was dismissed without prejudice to

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[2] In his original complaint, plaintiff advanced a second cause of action claiming wrongful use of civil proceedings. This claim was previously dismissed by the Court as settled.

refile, cross motions for summary judgment were pending. These motions were also dismissed without prejudice to renew. The Ninth Circuit's decision in *Layman* was handed down on December 17, 1992, and on January 19, 1993, the parties' were granted leave to redocket this case and to refile their cross motions for summary judgment. Also, the parties were directed to supplemental their motions in light of the *Layman* decision. These supplemental pleadings have been filed and the renewed cross motions for summary judgment are now fully submitted.

Defendant seeks dismissal of this case based on two arguments: 1) that under the federal securities laws, recovery of costs should be permitted only if it is found that the underlying lawsuit lacked merit; and, 2) that the indemnity clause was only designed to apply to situations where plaintiff's private placement registration exemption was lost.

1. Costs under the securities laws:

Defendant points out that the third sentence of the indemnity clause provides that he retains all rights under federal and state securities laws. One of those rights, says defendant, is that a plaintiff in a securities lawsuit is liable for costs only if the suit lacks merit. 15 U.S.C. § 77k(e).

In advancing this argument, defendant adds words to the statute that it does not contain. The relevant portion of § 77k(e) reads "costs may be assessed in favor of such party litigant (whether or not such undertaking has been required) if the court believes the suit or the defense to have been without merit." Nowhere in § 77k(e) does the word *only* appear, and this Court will not add the word *only* by judicial fiat. Absent any explicit statutory language or any supportive case law (defendant has cited none), the Court cannot conclude that assessment of costs is *only*

proper upon a finding that the defendant's prior claims lacked merit.[3]

2. The intent of the indemnity clause:

Defendant also argues that the indemnity clause, when placed in the context of the entire document, is limited to untrue representations that result in a loss of the registration exemption. In support of this argument, defendant notes that many of the warranties in the subscription agreement track verbatim the language of 17 C.F.R. §§ 230.501-508, which sets out the sophistication requirements of the registration exemption. Further, the private placement memorandum states that the suitability standards set forth in the subscription agreement "are designed to ensure compliance with [the registration exemption prerequisites]." Defendant concludes, and would have this Court find as a matter of law, that since Spendthrift did not lose its registration exemption as a result of defendant's actions, the indemnity clause is not applicable.

For this conclusion, defendant draws support from the rulings of the District Court in California, and the majority of the Ninth Circuit Court of Appeals. In affirming *Stratmore*, the *Layman* court held that the "expressed intent of the [indemnity] clause is that any investor whose breach of a representation causes the sellers to lose their private

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[3] Even if the statute did provide that costs could only be assessed by the Court if it believes the suit to have been without merit, plaintiff would not be foreclosed from recovery under the indemnity clause. Section 77k(e) applies to a court-ordered assessment of costs. In this case, the conditions concerning the payment of costs were set out in an agreement between the parties. If costs are to be paid be defendants, it would not be through a court-ordered assessment, but rather becasue such paument is mandated by the parties' own agreement.

placement exemption is obliged to reimburse the sellers for their losses. . . . a reasonable investor who read the PPM [private placement memorandum] and the subscription agreement would so interpret the indemnification clause." *Layman*, 981 F.2d at 1100.

This Court has reviewed the record and the documents under dispute and cannot find as a matter of law that the indemnification clause is limited to situations where Spendthrift looses its registration exemption. In arriving at this conclusion, this Court was mindful that under Kentucky law, the right to recovery pursuant to an indemnity contract is "well recognized", and indemnity contracts "[are] not against public policy and will be enforced if the indemnitee has suffered loss thereunder and has complied with its terms." *U.S. Fidelity & Guar. Co. v. Napier Elec.*, 571 S.W.2d, 644, 646 (Ky. App. 1978), quoting *National Surety Corp. v. Peoples Milling Co.*, 57 F.Supp. 281, 282 (W.D.Ky. 1944).

Although this Court has been unable to discover any Kentucky cases dealing with an indemnity clause similar to the one presently under consideration, cases exist in other jurisdiction where such indemnity clauses have been examined. These other jurisdictions are split as to their conclusions regarding the enforceability of the indemnity clauses, and it cannot be said that any clear majority rule exists. Compare *Stratmore v. Combs,* 723 F. Supp. 458 (N.D. Cal. 1989) and *Layman v. Combs*, 981 F.2d 1093 (9th Cir. 1992) with *Zissu v. Bear, Stearns & Co.*, 627 F. Supp. 687 (S.D.N.Y. 1986) *aff'd on other grounds*, 805 F.2d 75 (2d Cir. 1986), and *Barnebey v. E.F. Hutton & Co.*, 715 F. Supp. 1512 (M.D.Fla. 1989). These decisions have clearly set out many of the general arguments for and against

enforcement of indemnity clauses like the one at the center of this case, and it is unnecessary for this Court to restate those arguments. Instead, in light of Kentucky's well recognized policy of upholding the right of recovery under indemnity contracts, this Court has considered the specific facts of this case, and the specific wording of the clause under dispute.

This Court cannot ignore the fact that several of the warranties contained in the subscription agreement and referred to in the indemnity clause do not track the requirements of 17 C.F.R. §§ 230.501-508. These additional warranties go beyond those required by the securities laws. *See Layman*, 981 F.2d at 1105. A ruling that the indemnification clause is limited as asserted by defendant would nullify the additional warranties, which were agreed to by the parties, and which were just as much a part of the subscription agreement as were those warranties which track the regulations. Even if it were so inclined, which it is not, the Court has been shown no authority which would allow it to edit the subscription agreement in the manner suggested by defendant.

It is also apparent that the plain language of the indemnity clause does not limit indemnification to the situation where the registration exemption is lost, and, in fact, makes no mention at all of the registration exemption. Although Spendthrift's desire to retain the registration exemption was certainly one of the reasons for the inclusion of the warranties and the indemnity clause, nothing contained in the clause itself, or in the other relevant documents make the indemnity clause exclusively operative in cases of the loss of the registration exemption. The books are full of cases where sellers of securities have been sued

by disappointed investors claiming "But, I didn't know", "But, you didn't tell me", or "But, I had no reason to believe this investment was inappropriate for me." The plain language of the indemnity clause does not foreclose Spendthrift's intention to insulate itself from such claims.

The first sentence of the indemnity clause refers generally to a potential buyer's "qualification and suitability to purchase". The defendant would have this Court conclude that this phrase refers solely to the question of whether a potential buyer is qualified and suitable to purchase without causing Spendthrift to loose its registration exemption. Again, defendant attempts to add words where those words simply do not exist. The court is not inclined to rewrite the subscription agreement and include an explanation of the purpose of the indemnity clause, *at this point in the case.* We can only find that the express language of the indemnity clause, when viewed in the context of the entire document, is not as a matter of law limited to situations where Spendthrift's registration exemption is lost by a buyer's breach of the warranties of the subscription agreement.

The Court recognizes that a rational finder of fact could interpret the first sentence as does defendant. However, in light of the additional warranties of the subscription agreement, and the broad language of the indemnity clause, the Court finds that a rational trier of fact could also conclude that the indemnity clause was not limited to situations where the registration exemption was lost. For these reasons, issues of material fact exist, and defendant's motion for summary judgment must be denied.

For these same reasons, plaintiff's motion for partial summary judgment must also be denied. Plaintiff would have this Court hold that defendant's undisputed breach of

the warranties of the subscription agreement requires, as a matter of law, that he be indemnified pursuant to the second sentence of the indemnity clause. However, this position presupposes that the indemnity clause is applicable in the present situation and that the parties did not intend to limit the application of the indemnity clause as asserted by defendant. As set out above, the applicability of the indemnity clause is an issue for the trier of fact and thus cannot be decided on motions for summary judgment. Plaintiff's motion for partial summary judgment will also be denied, and this case shall be placed on a trial schedule by subsequent orders of the Court.

Accordingly,

IT IS THEREFORE ORDERED AND ADJUDGED:

(1) That defendant's motion for summary judgment is DENIED;

(2) That plaintiff's motion for partial summary judgment is DENIED;

This 4th day of June, 1993.

HENRY R. WILHOIT, JR., JUDGE

APPENDIX D

15 U.S.C. § 77k

UNITED STATES CODE

TITLE 15. COMMERCE AND TRADE

CHAPTER 2A--SECURITIES AND TRUST INDENTURES

SUBCHAPTER I--DOMESTIC SECURITIES

§ 77k. Civil liabilities on account of false registration statement

(a) Persons possessing cause of action; persons liable

In case any part of the registration statement, when such part became effective, contained an untrue statement of a material fact or omitted to state a material fact required to be stated therein or necessary to make the statements therein not misleading, any person acquiring such security (unless it is proved that at the time of such acquisition he knew of such untruth or omission) may, either at law or in equity, in any court of competent jurisdiction, sue--

(1) every person who signed the registration statement;

(2) every person who was a director of (or person performing similar functions) or partner in the issuer at the time of the filing of the part of the registration statement with respect to which his liability is asserted;

(3) every person who, with his consent, is named in the registration statement as being or about to become a director, person performing similar functions, or partner;

(4) every accountant, engineer, or appraiser, or any person whose profession gives authority to a statement

made by him, who has with his consent been named as having prepared or certified any part of the registration statement, or as having prepared or certified any report or valuation which is used in connection with the registration statement, with respect to the statement in such registration statement, report, or valuation, which purports to have been prepared or certified by him;

(5) every underwriter with respect to such security.

If such person acquired the security after the issuer has made generally available to its security holders an earning statement covering a period of at least twelve months beginning after the effective date of the registration statement, then the right of recovery under this subsection shall be conditioned on proof that such person acquired the security relying upon such untrue statement in the registration statement or relying upon the registration statement and not knowing of such omission, but such reliance may be established without proof of the reading of the registration statement by such person.

(b) Persons exempt from liability upon proof of issues

Notwithstanding the provisions of subsection (a) of this section no person, other than the issuer, shall be liable as provided therein who shall sustain the burden of proof--

(1) that before the effective date of the part of the registration statement with respect to which his liability is asserted (A) he had resigned from or had taken such steps as are permitted by law to resign from, or ceased or refused to act in, every office, capacity, or relationship in which he was described in the registration statement as acting or agreeing to act, and (B) he had advised the Commission

and the issuer in writing that he had taken such action and that he would not be responsible for such part of the registration statement; or

(2) that if such part of the registration statement became effective without his knowledge, upon becoming aware of such fact he forthwith acted and advised the Commission, in accordance with paragraph (1) of this subsection, and, in addition, gave reasonable public notice that such part of the registration statement had become effective without his knowledge; or

(3) that (A) as regards any part of the registration statement not purporting to be made on the authority of an expert, and not purporting to be a copy of or extract from a report or valuation of an expert, and not purporting to be made on the authority of a public official document or statement, he had, after reasonable investigation, reasonable ground to believe and did believe, at the time such part of the registration statement became effective, that the statements therein were true and that there was no omission to state a material fact required to be stated therein or necessary to make the statements therein not misleading; and (B) as regards any part of the registration statement purporting to be made upon his authority as an expert or purporting to be a copy of or extract from a report or valuation of himself as an expert, (i) he had, after reasonable investigation, reasonable ground to believe and did believe, at the time such part of the registration statement became effective, that the statements therein were true and that there was no omission to state a material fact required to be stated therein or necessary to make the statements therein not misleading, or (ii) such part of the registration statement did not fairly represent his statement as an expert or was not a

fair copy of or extract from his report or valuation as an expert; and (C) as regards any part of the registration statement purporting to be made on the authority of an expert (other than himself) or purporting to be a copy of or extract from a report or valuation of an expert (other than himself), he had no reasonable ground to believe and did not believe, at the time such part of the registration statement became effective, that the statements therein were untrue or that there was an omission to state a material fact required to be stated therein or necessary to make the statements therein not misleading, or that such part of the registration statement did not fairly represent the statement of the expert or was not a fair copy of or extract from the report or valuation of the expert; and (D) as regards any part of the registration statement purporting to be a statement made by an official person or purporting to be a copy of or extract from a public official document, he had no reasonable ground to believe and did not believe, at the time such part of the registration statement became effective, that the statements therein were untrue, or that there was an omission to state a material fact required to be stated therein or necessary to make the statements therein not misleading, or that such part of the registration statement did not fairly represent the statement made by the official person or was not a fair copy of or extract from the public official document.

(c) Standard of reasonableness

In determining, for the purpose of paragraph (3) of subsection (b) of this section, what constitutes reasonable investigation and reasonable ground for belief, the standard of reasonableness shall be that required of a prudent man in the management of his own property.

(d) Effective date of registration statement with regard to underwriters

If any person becomes an underwriter with respect to the security after the part of the registration statement with respect to which his liability is asserted has become effective, then for the purposes of paragraph (3) of subsection (b) of this section such part of the registration statement shall be considered as having become effective with respect to such person as of the time when he became an underwriter.

(e) Measure of damages; undertaking for payment of costs

The suit authorized under subsection (a) of this section may be to recover such damages as shall represent the difference between the amount paid for the security (not exceeding the price at which the security was offered to the public) and (1) the value thereof as of the time such suit was brought, or (2) the price at which such security shall have been disposed of in the market before suit, or (3) the price at which such security shall have been disposed of after suit but before judgment if such damages shall be less than the damages representing the difference between the amount paid for the security (not exceeding the price at which the security was offered to the public) and the value thereof as of the time such suit was brought: Provided, That

if the defendant proves that any portion or all of such damages represents other than the depreciation in value of such security resulting from such part of the registration statement, with respect to which his liability is asserted, not being true or omitting to state a material fact required to be stated therein or necessary to make the statements therein not misleading, such portion of or all such damages shall not be recoverable. In no event shall any underwriter (unless such underwriter shall have knowingly received from the issuer for acting as an underwriter some benefit, directly or indirectly, in which all other underwriters similarly situated did not share in proportion to their respective interests in the underwriting) be liable in any suit or as a consequence of suits authorized under subsection (a) of this section for damages in excess of the total price at which the securities underwritten by him and distributed to the public were offered to the public. In any suit under this or any other section of this subchapter the court may, in its discretion, require an undertaking for the payment of the costs of such suit, including reasonable attorney's fees, and if judgment shall be rendered against a party litigant, upon the motion of the other party litigant, such costs may be assessed in favor of such party litigant (whether or not such undertaking has been required) if the court believes the suit or the defense to have been without merit, in an amount sufficient to reimburse him for the reasonable expenses incurred by him, in connection with such suit, such costs to be taxed in the manner usually provided for taxing of costs in the court in which the suit was heard.

(f) Joint and several liability

All or any one or more of the persons specified in subsection (a) of this section shall be jointly and severally

liable, and every person who becomes liable to make any payment under this section may recover contribution as in cases of contract from any person who, if sued separately, would have been liable to make the same payment, unless the person who has become liable was, and the other was not, guilty of fraudulent misrepresentation.

(g) Offering price to public as maximum amount recoverable

In no case shall the amount recoverable under this section exceed the price at which the security was offered to the public.

APPENDIX E

15 U.S.C. 78cc

UNITED STATES CODE

TITLE 15. COMMERCE AND TRADE

CHAPTER 2B--SECURITIES EXCHANGES

§ 78cc. Validity of contracts

(a) Waiver provisions

Any condition, stipulation, or provision binding any person to waive compliance with any provision of this chapter or of any rule or regulation thereunder, or of any rule of an exchange required thereby shall be void.

(b) Contract provisions in violation of chapter

Every contract made in violation of any provision of this chapter or of any rule or regulation thereunder, and every contract (including any contract for listing a security on an exchange) heretofore or hereafter made, the performance of which involves the violation of, or the continuance of any relationship or practice in violation of, any provision of this chapter or any rule or regulation thereunder, shall be void (1) as regards the rights of any person who, in violation of any such provision, rule, or regulation, shall have made or engaged in the performance of any such contract, and (2) as regards the rights of any person who, not being a party to such contract, shall have acquired any right thereunder with actual knowledge of the facts by reason of which the making or performance of such contract was in violation of any such provision, rule, or regulation: Provided, (A) That no contract shall be void by reason of this subsection because of any violation of any rule or regulation prescribed pursuant to paragraph (3) of

subsection (c) of section 78o of this title, and (B) that no contract shall be deemed to be void by reason of this subsection in any action maintained in reliance upon this subsection, by any person to or for whom any broker or dealer sells, or from or for whom any broker or dealer purchases, a security in violation of any rule or regulation prescribed pursuant to paragraph (1) or (2) of subsection (c) of section 78o of this title, unless such action is brought within one year after the discovery that such sale or purchase involves such violation and within three years after such violation. The Commission may, in a rule or regulation prescribed pursuant to such paragraph (2) of such section 78o(c) of this title, designate such rule or regulation, or portion thereof, as a rule or regulation, or portion thereof, a contract in violation of which shall not be void by reason of this subsection.

(c) **Validity of loans, extensions of credit, and creation of liens; actual knowledge of violation**

Nothing in this chapter shall be construed (1) to affect the validity of any loan or extension of credit (or any extension or renewal thereof) made or of any lien created prior or subsequent to the enactment of this chapter, unless at the time of the making of such loan or extension of credit (or extension or renewal thereof) or the creating of such lien, the person making such loan or extension of credit (or extension or renewal thereof) or acquiring such lien shall have actual knowledge of facts by reason of which the making of such loan or extension of credit (or extension or renewal thereof) or the acquisition of such lien is a violation of the provisions of this chapter or any rule or regulation thereunder, or (2) to afford a defense to the collection of any debt or obligation or the enforcement of

any lien by any person who shall have acquired such debt, obligation, or lien in good faith for value and without actual knowledge of the violation of any provision of this chapter or any rule or regulation thereunder affecting the legality of such debt, obligation, or lien.

APPENDIX F

SUBSCRIPTION AGREEMENT

INSTRUCTIONS: A Subscriber to Spendthrift Farm, Inc., should deliver the following to Leslie Combs II, Brownell Combs II, Spendthrift Farm, Inc.; P.O. Box 996; Lexington, Kentucky 40588, directly:

(a) two completed, executed and notarized copies of the Signature Page which Signature Page is part of Appendix D-4 to the Private Placement Memorandum dated April 1, 1983 (the "Memorandum");

(b) a check in the amount of $1,000,000 with respect to each Unit purchased payable to Central Bank & Trust Company, Lexington, Kentucky, Escrow Account-Spendthrift offering.

(c) an executed Purchaser Questionnaire (Appendix D-2 to the Memorandum);

(d) if required, an executed Purchaser Representative Questionnaire (Appendix D-3) to the Memorandum); and,

(e) an executed Acknowledgement of Receipt of the Memorandum (Appendix D-1) to the Memorandum).

Subscriptions for shares must be received on or prior to June 30, 1983, unless the Seller, in its sole and absolute discretion, extends that date through a date not later than September 30, 1983. The Seller reserves the right to reject any subscriptions in its absolute and sole discretion, and to allot to any prospective investor less than the number of shares applied for by such investor. The Seller may modify or terminate this offering at any time prior to the acceptance of any subscription.

The undersigned (the "Subscriber") hereby offers to purchase a number of units (the "Units") set forth on the Subscriber's Signature Page representing shares in the Company, a Kentucky corporation, on the terms and conditions set forth in the Memorandum.

1. *Subscription*. The Subscriber subscribes to the number of Units indicated on the Signature Page submitted to the Sellers, at a purchase price of One million dollars, ($1,000,000) each.

2. *Acknowledgement of Receipt of Memorandum*. The Subscriber acknowledges receipt of the Memorandum, by executing the Acknowledgement of Receipt of the Memorandum (in the form set forth in Appendix D-1 to the Memorandum). The Subscriber agrees to be bound by the terms and conditions of an investment in the shares set forth in the Memorandum, subject only to acceptance of this subscription by the Sellers.

3. *Binding Effect of Subscription*. The Subscriber acknowledges that the Sellers will rely on this Subscription Agreement and accordingly acknowledges that on delivery of this executed Subscription Agreement, by delivery of the Signature Page, the Subscriber will become bound by its terms. This Subscription Agreement cannot be revoked, cancelled or terminated by the Subscriber after expiration of any applicable recession period under state law and, unless his subscription is rejected or the offering of shares in not consummated, the Subscriber will become a shareholder in the Company.

4. *Representations and Warranties*: The Subscriber hereby represents and warrants that:

(a) he is financially able to bear the economic risk of his investment subscribed hereunder for an indefinite period of time with no return thereon; he can afford a complete loss of his investment in the shares; he has adequate means of providing for his current needs and foreseeable future contingencies without regard to this particular investment, and anticipates no need in the foreseeable future to sell the shares for which he hereby subscribes; and he does not have an overall commitment to investments that are not readily marketable that is disproportionate to his net worth and this investment will not cause his investments that are not readily marketable to become disproportionate to his net worth;

(b) if he is a natural person, at the time of making his investment he has a net worth or joint worth with his spouse in excess of $5,000,000.00; or,

(c) if it is an entity, each of the equity owners thereof satisfies the requirements of clause (b) above;

(d) if it is a corporation or other organization, it has at the time of making the investment total assets in excess of $5,000,000.00;

(e) he has received and read and is familiar with the Memorandum including each of the exhibits annexed thereto and any amendments thereof, and he confirms that all documents, records and books pertaining to his proposed investment in the Company have been made available to him and/or his Purchaser Representative (as defined in Rule 501 promulgated under the Securities Act of 1933, as amended (the "1933 Act");

(f) he has, either alone or with his Purchaser Representative, if any, such knowledge and experience in financial

and business matters that he is capable of evaluating the merits and risks of the prospective investment in the Units of common stock in the Company;

(g) he and/or his Purchaser Representative has had an opportunity to ask questions of and receive answers from the Sellers, or any person or persons acting on behalf of the Sellers, concerning the terms and conditions of this investment in the Units, and all such questions have been answered to his full satisfactions and/or that of his Purchaser Representative;

(h) he and/or his Purchaser Representative has carefully reviewed and fully understands the information contained in or attached as an exhibit to the Memorandum; he understands that any assignment of shares, in whole or in part, is subject to substantial restrictions contained in the Memorandum; he further understands that there will be no market for the shares, and accordingly it may be not possible for him to readily liquidate his investment therein if he should need or desire to do so;

(i) he is purchasing his shares solely for his own personal account for investment only, and not with a view to reselling, distributing, splitting, sharing or otherwise disposing of same; he has no arrangement or commitment, formal or informal, with any person(s) to sell, transfer or pledge same or any part thereof, and he has no present plans to enter into any such arrangement or commitment; he understands the legal consequences of the foregoing representations and warranties to mean that he must bear the economic risk of his investment in the shares for an indefinite period of time because the shares have not been registered under the 1933 Act or any state securities laws, and cannot be sold unless subsequently registered under the

1933 Act or any applicable state securities laws, unless an exemption from registration should be available (as to which there is no assurance);

(j) he will not sell, transfer, assign or otherwise dispose of his shares, without having delivered to the Sellers, if so requested, an unqualified opinion of counsel, in form and substance satisfactory to the Sellers, that the proposed disposition complies with the 1933 Act and any applicable federal and state securities laws and regulations;

(k) he understands that the Sellers and the Company in offering the shares for sale without registration are relying upon the truth and accuracy of the representations and warranties made by him in this Subscription Agreement, and in the Purchaser Questionnaire submitted by him to the Sellers and the Purchaser Representative Questionnaire of his Purchaser Representative, if any; and that he is required, upon request of the Sellers, to provide such information as may be necessary to substantiate the accuracy of such representations and warranties;

(l) he understands that in view of the Securities and Exchange Commission (the "Commission") the statutory basis for the exemption claimed would not be present if, notwithstanding each investor's representations and warranties, any of the investors has in mind merely acquiring any of the Units for resale upon the occurrence of non-occurrence of some predetermined event or if any investor is not financially responsible;

(m) it has been called to his attention both in the Memorandum and by those individuals with whom he has dealt in connection with his investment in the shares that his investment in the Company involves a substantial degree of financial risk;

(n) he has received no representations or warranties from the Sellers or any of the Sellers officers, directors, employees or agents other than those contained in the Memorandum;

(o) by virtue of his own knowledge and experience in financial and business matters, he is capable of evaluating the merits and risks of making an investment in the Company, or, in the alternative, he has indicated the name and address of his Purchaser Representative(s) in the space provided in the Signature Page and he and his Purchaser Representative together have such knowledge and experience, and are therefore capable of evaluating the merits and risks of making this investment; and,

(p) he will use the Memorandum solely for his own review and will not further distribute it except to his designated Purchaser Representative(s), if any;

(q) he recognizes that no State or Federal government authority has made any finding or determination relating to the fairness for investment of the Shares and that no State or Federal government authority has recommended or endorsed or will recommend or endorse an investment in the Shares;

(r) he understands that the Offering of the Shares has not been reviewed by any official of any State because of the Seller's representations that this is intended to be an offering that is exempt from registration under the 1933 Act and that is non public pursuant to Rules 505 and 506, respectively, promulgated under the 1933 Act and that if all of the conditions and limitations of said rules are not compiled with, the Offering may be submitted to such officials for amended exemption. He understands that any offering literature used in connection with the Offering has

not been prefiled with or reviewed by any state official. He further understands that the books and records of the Company will be available upon reasonable notice for inspection by Subscribers during reasonable business hours at the principal place of business of the Company.

(s) he agrees not to transfer or assign this Subscription or any interest therein and agrees that it this Subscription is accepted, the assignment and transferability of the Shares subscribed by him will be governed by all applicable laws;

(t) if the undersigned is a partnership, consisting of one or more trusts and/or one or more individuals and/or one or more corporations, each of the partners will sign the Signature Page by authorizing the Subscriber to so sign on behalf of such partnership and, by so signing, each such partner represents and warrants that (i) each of the representations or agreements or understandings set forth herein applies to that partner, and (ii) the person who has signed on behalf of the partnership identified as the Subscriber is authorized to so sign; in the case of any partner that is a trust, a trustee (or co-trustee) of the trust is authorized by the trust agreement to make this investment and to enter into this Subscription Agreement; and in the case of any partner that is a corporation, the corporate officer so signing is authorized to sign on behalf of the corporation and will, upon request of the Company or counsel to the Company, furnish to the Company not only the appropriate language of the Articles of Incorporation or By-Laws, or both, authorizing the corporation to make such investment, but also appropriate corporate minutes authorizing the specific investment;

(u) he further understands that no assurances can be given that the financial results of operations will be achieved by the Company.

(v) SUBSCRIBER ACKNOWLEDGES THAT HE UNDERSTANDS THAT THE FINANCIAL INFORMATION PRESENTED IN THE MEMORANDUM IS UNAUDITED AND THAT NO PROVISION HAS BEEN MADE FOR DEFERRED TAXES.

5. *Indemnification*. The foregoing representations and warranties are made by the Subscriber with the intent that they may be relied upon in determining his qualification and suitability to purchase Shares, and the Subscriber hereby agrees that such representations and warranties shall survive his purchase thereof. The Subscriber hereby agrees to indemnify and hold harmless the Company, the Sellers and agents of each of them from and against any losses, claims, damages, liabilities, expenses (including attorneys' reasonable fees and disbursements), judgements and amounts paid in settlement resulting from the untruth of any of the warranties and representations contained herein, or the breach by the Subscriber of any of the covenants made by him herein. Notwithstanding the foregoing, however, no representation, warranty, acknowledgement or agreement by the Subscriber made herein shall in any manner be deemed to constitute a waiver of any rights granted to him under Federal or State securities laws.

6. *Limitation on Assignment of Shares*. The Subscriber acknowledges that he is aware that there are substantial restrictions on the assignability of the Shares. Since the Shares will not be registered under the 1933 Act or any applicable State securities laws, and the Subscriber has no right, other than the rights designated in the Memo-

randum, to require that they be so registered, the Shares may not be and the Subscriber agrees that they shall not be, sold, transferred, or otherwise disposed of unless such sale, transfer, or disposition does not require registration under the 1933 Act or any applicable State securities laws. The Subscriber also acknowledges that he shall be responsible for compliance with all conditions on transfer imposed by the 1933 Act, any applicable State securities laws or any securities law administrator, and will hold the Company and the Sellers harmless from any violation of the foregoing.

7. *Right of Sellers to Reject Subscription.* The Subscriber understands and agrees that the Sellers reserve the absolute right to reject any subscription received for, among other reasons, failure to satisfy any of the conditions of this subscription, insufficient documentation, over-subscription to the offering, or such other reasons as the seller determines to be in the best interests of the Company in their sole discretion. Upon acceptance of this subscription, the Sellers will forward to the Subscriber a copy of his Signature Page signed by the Sellers signifying acceptance of his subscription.

8. *Legends Restricting Transferability.* The Subscriber agrees that any instrument that may be issued to evidence ownership of the Shares will be imprinted with a conspicuous legend stating that the Shares have not been registered under the 1933 Act or any State securities laws, and referring to the restrictions on the assignability of the Shares.

9. IN WITNESS WHEREOF, the undersigned executes and agrees to be bound by this Subscription Agreement by executing and delivering a Signature Page in the form attached hereto on the date therein indicated.

No. _____

In the Supreme Court of the United States

October Term, 1993

FRANK L. BRYANT, KEMPER SECURITIES, INC., a Delaware Corporation (formerly known as BATEMAN EICHLER, HILL RICHARDS, INC.), CHARLES R. HEMBREE, and KINCAID, WILSON, SCHAEFFER & HEMBREE, P.S.C., a Kentucky Corporation,

PETITIONERS,

v.

CALVIN KLEIN, GEORGE E. LAYMAN, JR., GEORGE E. LAYMAN, ZENYA YOSHIDA, DBA SHADAI FARMS, KENNETH FRANZHEIM, II, BLAS R. CASARES, EARL H. SHULTZ, RICHARD L. SCHULTZ, VIRGINIA M. McGONIGLE, JOHN F. McGONIGLE, H. JAMES GRIGGS, BARRY K. SCHWARTZ, FOREST ACRES PARTNERSHIP, a Washington State General Partnership, BARRY K. SCHWARTZ PARTNERSHIP, a New York Partnership and ROBERT D. STRATMORE,

RESPONDENTS.

PROOF OF SERVICE BY MAIL

State of California

ss.

County of Los Angeles

I, the undersigned, say: I am and was at all times herein mentioned, a citizen of the United States and a resident of the County of Los Angeles, over the age of

eighteen (18) years and not a party to the within action or proceeding; that my business address is 9105 Sunset Boulevard, West Hollywood, California 90069; that on August 9, 1993, I served the within *Appendices To Petition For A Writ Of Certiorari To The United States Court Of Appeals For The Ninth Circuit* in said action or proceeding on all parties required to be served by depositing true copies thereof, enclosed in a sealed envelope with first class postage thereon fully prepaid, in the United States mail at Los Angeles, California, addressed as follows:

Clerk, United States Supreme Court
One First Street, N.E.
Washington, D.C. 20543
(*By Express Mail: Original and Forty Copies*)

Clerk, United States Court of Appeals
Ninth Judicial Circuit
121 Spear Street
San Francisco, California 94119-3939
(Three Copies)

John I. Alioto, Esq.
Alioto & Alioto
505 Montgomery St., 10th Floor
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Counsel for Blas R. Casares
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Pillsbury, Madison & Sutro
P.O. Box 7880
San Francisco, California 94120-7880
Counsel for Zenya Yoshida, dba
Counsel for Zenya Yoshida, dba
(Three Copies)

I declare under penalty of perjury that the foregoing is true and correct. Executed on August 9, 1993, at Los Angeles, California.

Betty J. Malloy
(Original Signed)